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In the Supreme Court of the United States

OCTOBER TERM, 1984

**BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM**

v.

DIMENSION FINANCIAL CORP., ET AL.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT**

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QUESTION PRESENTED

Section 2(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)) defines a "bank" as any institution that "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." The question in this case is whether the Federal Reserve Board properly exercised its discretion in determining that the first prong of this definition includes deposits that as a matter of universal practice are paid on demand, and that commercial lending includes the purchase of commercial paper, retail installment loans, and similar money market instruments.

II

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Daniel T. Carroll, Harold D. Dufek, William T. Mitchell, Ronald L. Shaffer, A. Gary Shilling, the State of Ohio, Ohio Division of Savings and Loan Associations, Ohio Deposit Guarantee Fund, Horizon Savings and Loan Company, Permanent Savings and Loan Association, Financial Institutions Assurance Corporation, First Bancorporation, Colorado Industrial Bankers Association, Fort Lupton Industrial Bank, Monroe Industrial Bank, Castle Rock Industrial Bank, Art Valley Industrial Bank, Household Weld County Industrial Bank, Household Lamar Industrial Bank, Household Alamosa Industrial Bank, Household Valley Industrial Bank, Household Salida Industrial Bank, Copper State Thrift & Loan Company, and Copper State Financial Corporation were petitioners in the court of appeals. American Financial Services Association and Household Finance Corporation were intervenors in the court of appeals.

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The Solicitor General, on behalf of the Board of Governors of the Federal Reserve System, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINION BELOW

The opinion of the court of appeals (App., *infra*, 1a-19a) is reported at 744 F.2d 1402.

JURISDICTION

The judgment of the court of appeals was entered on September 24, 1984. On December 13, 1984, Justice White extended the time for filing a petition for

a writ of certiorari to January 22, 1985. On January 14, 1985, Justice White further extended the time for filing to and including February 6, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

12 U.S.C. 1841(c) provides in relevant part:

"Bank" means any institution * * * which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans.

12 C.F.R. 225.2(a) (1) provides:

"Bank" means any institution organized under the laws of the United States that:

(i) Accepts deposits that the depositor has a legal right to withdraw on demand and

(ii) Engages in the business of making commercial loans. For the purposes of this definition:

(A) "Deposits that the depositor has a legal right to withdraw on demand" (hereinafter "demand deposits") means any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument; and

(B) "Commercial loans" means any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the pur-

chase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

STATEMENT

1. Section 2(c) of the Bank Holding Company Act of 1956 (BHCA or Act) (12 U.S.C. 1841(c)) defines a "bank" as "any institution * * * which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." The term "bank holding company," in turn, is used to "mean[] any company which has control over any bank" (12 U.S.C. 1841(a)(1)). The BHCA subjects such companies to extensive regulation. Among other things, bank holding companies may not own or control most types of nonbanking businesses (12 U.S.C. 1843(a) and (c)(8)), may not make interstate acquisitions of banks unless such acquisitions are expressly permitted by state law (12 U.S.C. 1842(d)), and may acquire additional banks only by satisfying the Federal Reserve Board's (Board) public interest and antitrust standards (12 U.S.C. 1842(c)). Bank holding companies also must comply with detailed registration and reporting requirements. 12 U.S.C. 1844(c).

This case concerns the place within the BHCA's regulatory scheme of institutions generally labeled "nonbank banks." Nonbank banks, while largely indistinguishable from banks (and while fully regulated by the Comptroller of the Currency pursuant to the National Bank Act, 12 U.S.C. 21 *et seq.*), have escaped treatment as banks under the BHCA by de-

clining either to accept demand deposits in the form of conventional checking accounts, or to make commercial loans in the form of "face-to-face" lending transactions. See generally App., *infra*, 24a, 25a. Thus, nonbanks typically offer negotiable order of withdrawal (NOW) accounts rather than conventional checking accounts (see *id.* at 32a, 38a-43a); while the depository institution theoretically retains a right to demand notice prior to withdrawal from a NOW account, in practice advance notice never is demanded (see *id.* at 39a-40a), and the NOW account functions as an interest-bearing checking account (see *id.* at 38a-40a).¹ Similarly, a nonbank bank that accepts

¹ NOW accounts are transaction accounts that "operate as demand checking accounts" (App., *infra*, 38a). Like the holder of a conventional checking account, "the holder of a NOW account makes withdrawals by means of a demand draft that may be issued to a third party as a means of transferring funds to the third party from the depositor. The payee of the NOW draft deposits it in the payee's bank for collection from the drawee institution. The drawee institution then charges the depositor's NOW account to pay the draft. * * * NOW drafts are cleared through the Federal Reserve check collection facilities as demand items, exactly like conventional checks." *Ibid.* In addition, NOW accounts "are uniformly advertised as checking accounts" (*id.* at 39a), and empirical evidence suggests that many depositors use NOW accounts as their principal checking accounts (*id.* at 39a n.21). Indeed, depositors have shifted a substantial portion of their funds from conventional checking to NOW accounts (see 67 Fed. Res. Bull. 595, 596 (1981)). The only functional differences between NOW accounts and conventional checking accounts are that NOW accounts are not available to most for-profit depositors (12 U.S.C. 1832(a)(2)) (although they may be used by sole proprietorships (12 C.F.R. 217.157(b))), and, of course, that NOW accounts offer interest.

Banks reserve the right to require notice prior to payment on a NOW account because federal law (12 U.S.C. 371a, 1828(g)(1); 12 C.F.R. 217.2) forbids the payment of inter-

demand deposits might invest its funds in commercial paper, federal funds and other money market instruments rather than negotiate face-to-face commercial loans (see App., *infra* 45a-46a).

In early 1984, the Board responded to a dramatic increase in the number of nonbank banks (see App., *infra*, 24a-25a) by amending its existing Regulation Y to ensure that nonbank banks would be treated as banks within the meaning of the BHCA. The Board noted that "NOW accounts in practice perform the same function as conventional demand deposits, are advertised and used in a manner indistinguishable from conventional bank checking accounts, and are subject to the same reserve requirements as conventional demand deposits" (*id.* at 38a). The Board also concluded that the purchase of money market and similar instruments "as a matter of law establish[es] a debtor-creditor relationship and constitute[s] an extension of credit or loan" (*id.* at 46a).

The amended Regulation Y accordingly defines "deposits that the depositor has a legal right to withdraw on demand" (12 U.S.C. 1841(c)(1)) to mean:

any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument
* * *

est on demand deposits. The depository institution's reservation of a theoretical right to demand seven days' notice prior to withdrawal prevents a NOW account from becoming a demand deposit within the meaning of the Board's definition of that term as it applies to those provisions (see 12 C.F.R. 217.1(e)(2)), and therefore avoids the interest prohibition. In fact, however, the Board is unaware of a single instance in which a depository institution has invoked a NOW account's notice requirement (App., *infra*, 40a).

12 C.F.R. 225.2(a)(1)(A). The regulation defines "commercial loan" (12 U.S.C. 1841(c)(2)) to mean:

any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

12 C.F.R. 225.2(a)(1)(B). The regulation thus includes as a bank within the meaning of the BHCA any institution that offers NOW checking accounts and makes commercial loans.² It also treats as a bank any institution that uses its funds to purchase short-term commercial obligations while accepting demand deposits.

2. Some of the issues presented by amended Regulation Y were first addressed by the Tenth Circuit in *First Bancorporation v. Board of Governors*, 728 F.2d 434 (1984). The court of appeals there overturned a Board ruling that a Utah industrial loan company offering NOW rather than conventional checking accounts is a bank within the meaning of the BHCA.³

² The Board noted that other types of transaction accounts also might fall within the definition (App., *infra*, 43a), but explained that "it is unlikely that there would be a significant number of depository institutions offering these accounts that do not also offer NOW or other checking accounts" (*ibid.*). The principal focus of the Board's ruling therefore was on NOW accounts (see *id.* at 32a-45a).

³ The Board order at issue (*First Bancorporation (Beehive Thrift & Loan)*, 68 Fed. Res. Bull. 253 (1982)) was the basis for the amendment to Regulation Y (see App., *infra*, 21a). The revised regulation was promulgated before the Tenth Circuit overturned the Board's *First Bancorporation* order.

In reaching its conclusion, the court noted that, under Utah law, industrial loan companies must reserve the right to demand 30 days' notice prior to the withdrawal of funds from a NOW account. 728 F.2d at 435. As a result—even though, as the court acknowledged, "withdrawals from NOW accounts are in actual practice permitted on demand" (*id.* at 436)—the court held that a depositor whose funds are held by a Utah industrial loan company has "no legal right of withdrawal on demand" (*ibid.*). The court also concluded that the statutory language must be interpreted narrowly because Congress used the "legal right to withdraw" formula rather than a broader "payable on demand" test (*id.* at 436-437). The court accordingly held that Utah industrial loan companies do not satisfy the "bank" definition set out in the BHCA.

3. Shortly after the promulgation of amended Regulation Y, respondents filed petitions challenging the regulation in the Fourth, Sixth and Tenth Circuits. These petitions all were transferred to the Tenth Circuit pursuant to 28 U.S.C. 2112(a). That court then invalidated both the demand deposit and the commercial loan aspects of the Board's regulation. On the demand deposit point, the court of appeals relied entirely on its *First Bancorporation* decision (App., *infra*, 4a, 18a).

On the commercial loan issue, the court first explained that "the new definition of [commercial loan] is not in accord with common usage" (App., *infra*, 8a), and that the Board in the past had ruled that an institution may engage in money market transactions without subjecting itself to treatment as a bank (*id.* at 5a-6a). "Such a complete change [in position]," the court opined, "and one that is a redefinition and

expansion of jurisdiction by an agency requires that different standards be met than are demanded in a typical administrative redefinition not involving such elements" (*id.* at 9a). The court also found support for its holding in the legislative history, concluding that the commercial loan proviso was added to the statute specifically to exempt from the BHCA only one institution, the Boston Safe Deposit & Trust Company; yet when the proviso was added, the court stated, Congress and the Board knew that the company was engaging in money market transactions of the sort that revised Regulation Y now treats as commercial loans (*id.* at 10a-11a). And the court noted that other federal agencies have disagreed with the Board's definition of commercial loan (*id.* at 7a, 17a).

Finally, the court of appeals reasoned that the Board "does not have the broad scope to work in as do many other agencies. * * * Instead, the BHCA limits the subject matter of the Board's functions basically to anticompetitive considerations" (App., *infra*, 12a). In combination with the other factors noted above, this consideration led the court to hold that "the limited authority of the Board [does not] permit[] it to itself bring about the change here attempted and a change in its own jurisdiction no matter how necessary it perceives the change to be * * *" (*id.* at 17a). The court of appeals therefore broadly enjoined the Board from implementing or enforcing the revised Regulation Y (*id.* at 19a).

REASONS FOR GRANTING THE PETITION

This case presents a question of paramount importance to the operation and structure of the nation's banking system. Since the enactment of the BHCA in 1956, the structure of that system has been based on

two firm principles: the strict separation of banking from other forms of commerce, and the prevention of undue concentration of control over banking facilities. See *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 46 (1980). To a significant degree, the court of appeals' decision would defeat those purposes by allowing the companies that control nonbank banks—which in reality are full-fledged banking institutions—to circumvent entirely the restrictions as to nonbanking activities, interstate operations, partiality in the credit-granting process, and anticompetitive acquisitions that are imposed on bank holding companies by the BHCA.

The legislative history of the Act makes it plain that 12 U.S.C. 1841(c) was not intended to permit such a development. Given this history and the basic statutory purposes—which, in combination, have convinced at least one other court of appeals to accept the Board's approach to the demand deposit aspect of the statutory definition—deference to the Board's expertise in interpreting and effectuating the meaning of the BHCA is entirely appropriate. Yet the Tenth Circuit misread or ignored the relevant legislative history, and failed even to acknowledge the Board's special role in administering most elements of the BHCA. When so flawed an appellate opinion will have such far-reaching consequences, review by this Court is appropriate.

1. The Tenth Circuit avoided any consideration of the consequences of its decision by resting its holding principally on the language of 12 U.S.C. 1841(c). In reading that language narrowly, however, the court improperly assumed that there is an "errorless test for identifying or recognizing 'plain' or 'unambiguous' language." *United States v. Turkette*, 452 U.S.

576, 580 (1981). At the same time, the court of appeals disregarded both the congressional intent underlying the BHCA and this Court's direction that, when construing a statute, "authoritative administrative constructions should be given the deference to which they are entitled, [and] absurd results * * * avoided." *Ibid.*

a. The court of appeals' mechanistic approach to the "legal right to withdraw on demand" prong of the BHCA is not compelled by the statutory language and is fundamentally inconsistent with the legislative history. As originally enacted, the BHCA defined a "bank" simply as "any national banking association or any State bank, savings bank, or trust company." Bank Holding Company Act of 1956, ch. 240, § 2, 70 Stat. 133, 12 U.S.C. 1841. The Board interpreted this definition in a functional manner, defining a bank as any institution that either "[1] accept[ed] deposits subject to check or [2] otherwise accept[ed] funds from the public that [were], in actual practice, repaid on demand." 49 Fed. Res. Bull. 166 (1963).⁴ Concerns were expressed, however, that the second prong of this definition would lead to the treatment of industrial and savings institutions as banks within the meaning of the Act.⁵ See 112 Cong. Rec. 12385

⁴ The Board issued its 1963 interpretation in the course of determining whether state industrial banks were "State bank[s]" within the meaning of the BHCA.

⁵ These institutions did not offer checking accounts. See 112 Cong. Rec. 12385 (1966) (remarks of Sen. Robertson). They did offer passbook savings accounts, however; withdrawals from such accounts, although subject to advance notice provisions, generally—but not invariably (see App., *infra*, 40a n.23)—are paid on demand. See, e.g., 21 Fed. Res. Bull. 863 (1935). Industrial or savings institutions therefore could have been swept within the second prong of the Board's 1963 definition.

(1966) (remarks of Sen. Robertson); *Amend the Bank Holding Company Act of 1956: Hearings on S. 2353, S. 2418 and H.R. 7371 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 155, 157 (1966) (1966 Hearings) (testimony of Max A. Denney). Congress—with the Board's endorsement (see 1966 Hearings 447)—responded to these concerns in 1966 by eliminating the second prong of the Board's test, and defining as a bank any institution that accepts deposits that the depositor has a legal right to withdraw on demand. Pub. L. No. 89-485, § 3, 80 Stat. 236, 12 U.S.C. 1841(c) (1).

While Congress made use of the "legal right to withdraw" formulation rather than a "payable on demand" test proposed by the Board (see 1966 Hearings 447), it plainly did not intend the statutory term to depart from the first prong of the Board's pre-existing definition. To the contrary, Congress explained that it had adopted "the commonly accepted test of whether an institution is a commercial bank." S. Rep. 1179, 89th Cong., 2d Sess. 7 (1966). In doing so, Congress was concerned not with the legal rights of depositors but with their ability to withdraw funds from their accounts by check. See *Wilshire Oil Co. v. Board of Governors*, 668 F.2d 732, 737 (3d Cir. 1981), cert. denied, 457 U.S. 1132 (1982). Thus the hallmark of a "bank," Congress made clear, was whether the "institution * * * accepts deposits payable on demand (checking accounts)" (S. Rep. 1179, *supra*, at 7); indeed, the Senate Report captioned its discussion of the amendment simply "[e]xclusion of institutions that do not accept checking accounts" (*ibid.* (emphasis omitted)). Industrial and savings banks were excluded from the definition because they did "not receive deposits in the form ordinarily re-

ceived by commercial banks" (112 Cong. Rec. 12386 (1966) (remarks of Sen. Robertson))—that is, they did not "accept demand deposits subject to check" (*id.* at 12385 (remarks of Sen. Robertson)).⁶

Institutions offering NOW accounts, however, undeniably do "accept demand deposits subject to check." Even the court of appeals acknowledged (*First Bancorporation*, 728 F.2d at 436) that NOW accounts are, in operation, identical to checking accounts. See App., *infra*, 38a-40a; note 1, *supra*. For its part, the Board has explained that it is unaware

⁶ The checking or transactional feature traditionally distinguished savings from other forms of accounts. See, e.g., 21 Fed. Res. Bull. 863 (1935); 13 Fed. Res. Bull. 609 (1927); 9 Fed. Res. Bull. 677 (1923); 1 Fed. Res. Bull. 38 (1915). In its comments prior to the 1966 amendment of the BHCA, the Board urged Congress to retain this test. 1966 *Hearings* 447. As the legislative history cited in text demonstrates, that is precisely what Congress did when it defined as a bank any institution that offers transactional "deposits payable on demand (checking accounts)." S. Rep. 1179, *supra*, at 7. This context compels the conclusion that Congress used the "legal right to withdraw language" not because it was concerned about the legal characteristics of the account; instead, Congress chose that term because it provided a shorthand method for excluding from coverage under the BHCA those industrial and savings banks that did not offer checking accounts. See note 5, *supra*. In using its own language rather than the Board's proposed "payable on demand" formulation, then, Congress was not—as the court of appeals believed (*First Bancorporation*, 728 F.2d at 436-437)—rejecting the Board's test. To the contrary, the legislative history describes the enacted language in the very terms the Board proposed, as "deposits payable on demand." In fact, Congress used all of these terms—"checking account," "demand deposit" and "deposit that the depositor has a legal right to withdraw on demand"—interchangeably, without any indication that the BHCA's meaning turned on technical distinctions between the terms.

of a single instance in which a NOW account's notice requirement (the only theoretical distinction between such accounts and other forms of demand deposits) has been invoked by a depository institution (App., *infra*, 40a).⁷ And when Congress for the first time approved the nationwide use of NOW accounts in 1980 (Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 303, 94 Stat. 146, 12 U.S.C. 1832), it flatly declared that such accounts functioned as both "interest bearing checking accounts" (S. Rep. 96-368, 96th Cong., 1st Sess. 2, 5, 7, 21 (1979); 125 Cong. Rec. 23791-23793 (1979) (remarks of Rep. St Germain); *id.* at 23797 (remarks of Rep. Wylie)) and "demand deposits" (S. Rep. 96-368, *supra*, at 5, 21).⁸ Indeed,

⁷ Indeed, the nature of a NOW account makes it unlikely that a depository institution ever would invoke the notice requirement. Withdrawals from NOW accounts typically are made by check to third party payees, and a bank could demand notice only by refusing payment to the payee. Presumably, "[p]ayees would thereafter refuse to accept NOW drafts drawn on that institution" (App., *infra*, 40a n.22). And the unlikelihood that notice ever will be invoked is compounded by the requirement that, when a bank demands notice prior to one depositor's withdrawal of funds from one account, it also must demand notice prior to every depositor's withdrawal of funds from a similar account. 12 C.F.R. 217.5(a).

⁸ This has been the consistent congressional view of the nature of NOW accounts since their introduction in the early 1970's. Thus Congress originally was reluctant to authorize use of NOW accounts because it believed that doing so would "infringe[] on a 40-year-old statutory prohibition on the payment of interest on checking accounts" (119 Cong. Rec. 16071 (1973) (remarks of Sen. Brock)). See also *id.* at 15002 (remarks of Rep. Patman) (characterizing NOW accounts as demand accounts); *id.* at 15004 (remarks of Rep. Johnson) (characterizing NOW accounts as checking accounts); *id.* at 16486 (remarks of Sen. Proxmire) (characterizing NOW accounts as demand deposits).

Congress has directed depository institutions to maintain reserves on all of their federally-insured "transaction accounts," thus treating NOW and conventional checking accounts interchangeably. 12 U.S.C. 461(b)(1)(C) and (2)(A).

Given the nature of NOW accounts, allowing the companies controlling nonbank banks to escape regulation under the BHCA inevitably will frustrate the purposes of the statute. The BHCA was enacted "to accomplish two primary objectives": "to prevent the concentration of banking resources in the hands of a few financial giants," and "to implement a congressional policy against control of banking and nonbanking enterprises by a single business entity." *Lewis*, 447 U.S. at 46. See S. Rep. 1095, 84th Cong., 1st Sess. 2 (1955). These policies were forcefully reiterated in 1966, when Congress enacted the demand deposit prong of the BHCA's bank definition. See S. Rep. 1179, *supra*, at 2-3, 7. Yet nonbank banks that offer NOW accounts and make commercial loans are functionally identical to banks. As a result, there is no doubt that the unchecked proliferation of nonbank banks permitted by the Tenth Circuit's interpretation of 12 U.S.C. 1841(c)(1) will permit the unregulated accumulation of banking resources by nonbanking entities, while allowing large institutions to control nationwide banking chains.

The statutory history and purposes outlined above have led one court of appeals to accept the Board's analysis of the BHCA's "legal right to withdraw on demand" language. In *Wilshire Oil Co. v. Board of Governors*, 668 F.2d 732 (3d Cir. 1981), cert. denied, 457 U.S. 1132 (1982), a bank attempted to avoid the BHCA's requirements by voluntarily reserving the right to demand 14 days' notice prior to the with-

drawal of funds from certain of its accounts, although it informed its customers that it had no intention of exercising that right. 668 F.2d at 734. The Third Circuit upheld the Board's ruling that the institution nevertheless remained a bank, explaining that its holding was supported by the necessity of preventing evasion of the BHCA (*id.* at 738-740) and by its conclusion that an institution offering both checking services and commercial loans "is the type of institution that Congress meant to include within the definition of a 'bank'" (*id.* at 738). It is impossible to square that reasoning with the Tenth Circuit's more formalistic analysis.⁹

b. The court of appeals' analysis of the Board's commercial loan definition also is based on several fundamental misconceptions. At the outset, the court was simply wrong in asserting that in 1970, when the commercial loan element was added to the BHCA's definition of a bank (Pub. L. No. 91-607, § 101(c), 84 Stat. 1762, 12 U.S.C. 1841(c)(2)), both the Board and Congress were aware that the Boston Safe Deposit & Trust Company—a beneficiary of the commer-

⁹ The Tenth Circuit attempted to distinguish *Wilshire* by noting that the latter case involved an effort by a bank holding company "to evade the Board's jurisdiction," while the record before the Tenth Circuit in *First Bancorporation* evinced no such intent (728 F.2d at 436). But this distinction is largely imaginary, for there is little doubt that a great many nonbank banks are organized to avoid the BHCA's requirements. The Tenth Circuit also noted that NOW accounts differ from conventional checking accounts in several ways: NOW accounts bear interest and are unavailable to commercial depositors (*ibid.*). But the court of appeals failed to suggest how these distinctions are at all relevant to the legal issue in the case.

cial loan amendment¹⁰—was engaging in money market transactions. Instead, the Board informed Congress only that “[t]o the best of our knowledge, this amendment would have very limited application at present, possibly affecting only one institution.” *One-Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, et al. Before the Senate Comm. on Banking and Currency, 91st Cong., 2d Sess. 137 (1970)*. No reference was made to the activities of that institution, and nothing in the legislative history of the 1970 amendment indicates that either the Board or Congress was familiar with all of the company’s operations. See note 10, *supra*.¹¹

The 1970 amendment itself contains no definition of “commercial loan.” Similarly, the legislative his-

¹⁰ The commercial loan requirement was added in committee on Senator Brooke’s motion (see 116 Cong. Rec. 42426 (1970) (remarks of Sen. Sparkman)). Congress subsequently was informed that “[v]irtually the only bank which does no commercial lending and therefore fits the description is the Boston Safe Deposit & Trust Co., a subsidiary of the Boston Co.” (*id.* at 25848) (remarks of Rep. Gonzalez) (reprinting *Financial Report: Banking Lobby Scores in Senate With Second Effort On One-Bank Holding Bill*, National Journal (July 18, 1970)). In 1966, the Boston Company had informed Congress that the Boston Safe Deposit & Trust Company was “primarily engaged in the fields of investment and property management and in the other fiduciary services usually identified with the fiduciary trust business” (1966 *Hearings* at 732). The company therefore asserted that it did “not engage in commercial lending” (*id.* at 733), and on that ground urged that any amendment to the Act be drawn so as to exclude it from coverage. Nothing in the 1970 legislative record—or in the Boston Company’s 1966 submission—described the company’s money market operations.

¹¹ It was not until 1972 that a Board ruling revealed that the company was engaging in money market transactions (see App., *infra*, 6a).

tory, which was largely devoted to other matters, contains no description of the nature of a commercial loan. See generally H.R. Rep. 91-1747, 91st Cong., 2d Sess. 23 (1970); S. Rep. 91-1084, 91st Cong., 2d Sess. 24 (1970); 116 Cong. Rec. 42426 (1970) (remarks of Sen. Sparkman). In lieu of such a discussion, Congress simply admonished the Board to “interpret [the] exemption[] as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest will, in fact, be covered.” H.R. Rep. 91-1747, *supra*, at 23. At the same time, Congress greatly expanded the scope of the Act by bringing within its provisions previously exempt holding companies, including those that owned only one bank, and by preventing banks from tying the availability of credit to a customer’s purchase of goods and services from the bank, its parent, or its sister subsidiaries. See *id.* at 11-12, 28-29; S. Rep. 91-1084, *supra*, at 1-4, 16-17. Congress thus explicitly reaffirmed its strong commitment to the separation of banking and commerce that is central to the BHCA. See H.R. Rep. 91-1747, *supra*, at 11, 21-22; S. Rep. 91-1084, *supra*, at 3. Given this congressional attitude, it was anomalous for the court of appeals to suggest that the 1970 BHCA amendment was intended to exempt a substantial number of commercially-affiliated banking institutions from the Act’s prudential restrictions.

Against this background, “the Board has articulated with commendable thoroughness” the reasons for its conclusion that revised Regulation Y’s definition of “commercial loan” is necessary to fulfill the statutory mandate. *Securities Industry Ass’n v. Board of Governors*, No. 83-614 (June 28, 1984), slip op. 8. The Board has explained that all of the transactions listed in the second prong of revised Regula-

tion Y “establish a debtor-creditor relationship and constitute an extension of credit” (App., *infra*, 46a). Similarly, all of the transactions are “commercial” in nature because all provide funds to commercial enterprises (including banks) “for working capital or current operations” (*id.* at 49a). See *United States v. Connecticut National Bank*, 418 U.S. 656, 665 (1974). While several comments on the revisions to Regulation Y expressed the view that the purchase of money market instruments invariably involves passive investing rather than lending (see App., *infra*, 46a, 56a-57a), the Board found that “a substantial portion of the transactions in all of [the listed] instruments occurs through direct negotiation between lenders and borrowers,” putting holders of the instruments “in a position to influence the conduct of the borrower” (*id.* at 55a). This state of affairs raises the danger, the Board concluded, that nonbank banks will invest excessively in their affiliates (*id.* at 56a), will improperly tie the availability of credit to the purchase of goods or services from sister subsidiaries (*ibid.*), or otherwise will become affiliated with unduly risky enterprises—results that the BHCA’s separation of banking from other forms of commerce was designed to forestall. See S. Rep. 1095, *supra*, at 4-5, 16; S. Rep. 91-1084, *supra*, at 2-4.

Indeed, the Board explained in considerable detail its reason for concluding that *each* of the listed transactions is a commercial loan—reasons that simply were not addressed by the court of appeals. The Board explained, for example, that commercial paper “is a prime quality, short-term unsecured promissory note establishing a debtor-creditor relationship between lender and borrower” (App., *infra*, 49a). This rationale is hardly flawed on its face; last year, this Court noted that “the authority to discount com-

mercial paper” places “banks in their traditional role as a prudent lender,” adding that banks acquire commercial paper as part of “the process of extending credit.” *Securities Industry Ass’n v. Board of Governors*, No. 82-1766 (June 28, 1984), slip op. 20, 21 n.11. Retail installment loans have a similar nature (see App., *infra*, 58a). Broker call loans are demand loans made to securities brokers (see *id.* at 59a). The other transactions listed in revised Regulation Y generally involve the lending of funds by one bank to another (see *id.* at 50a-58a).¹² While it may not be equally obvious that each of these transactions is a loan, the court of appeals plainly erred in upholding a facial challenge to the regulation and thereby invalidating the Board’s entire regulatory effort as inconsistent with the statutory language without so much as a reference to the rulemaking record.¹³

¹² The Board noted that these transactions raise the danger of indirect as well as direct evasion of the BHCA: “The possibility of ‘understandings’ involving the placing of funds derived from deposit taking by nonbank banks with banking institutions that would agree to take a favorable view toward lending to the nonbank bank’s industrial or commercial affiliates would circumvent the purposes of the Act and pose serious enforcement problems” (App., *infra*, 28a).

¹³ In reaching its conclusion, the court of appeals placed great weight on what it perceived as a change in the Board’s position on the definition of commercial loan. The court noted that, on several occasions since 1970, the Board has allowed institutions that were engaging in money market transactions to escape regulation as banks under the BHCA (App., *infra*, 5a-6a). This recent “complete change” in the Board’s position, the court explained, required the application of an unusually strict (although undefined) standard in judging the validity of the Board’s action (*id.* at 9a, 15a-16a). Even if we assume that the Board has changed its position “com-

c. Perhaps most fundamentally, the court of appeals' analysis and conclusions were grounded on a basic misconception of the Board's role. The court declined to defer to the Board's expertise for two reasons: because in its view "the BHCA limits the subject matter of the Board's functions basically to anti-competitive considerations" (App., *infra*, 12a), and because the Board's action would lead to "a change in its own jurisdiction" (*id.* at 17a).¹⁴ Both of these lines of analysis are fundamentally flawed.

plete[ly]," however, this approach plainly is incorrect. See *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Insurance Co.*, No. 82-354 (June 24, 1983), slip op. 10-11. To the contrary, this Court repeatedly has "recognize[d] that 'regulatory agencies do not establish rules of conduct to last forever,' *American Trucking Assoc., Inc. v. Atchison, T. & S.F.R. Co.*, 387 U.S. 397, 416 (1967), and that an agency must be given ample latitude to 'adapt their rules and policies to the demands of changing circumstances.' *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968)." *Motor Vehicle Mfrs. Ass'n*, slip op. 11. It is true, of course, that when an agency changes its approach it is "obligated to supply a reasoned analysis for the change." *Ibid.* But here the Board has done precisely that, explaining that "conditions have changed so that widespread evasion of the statute has developed through the combination of demand deposit-taking and the placing of the funds thus generated in money market commercial loans" (App., *infra*, 16a).

¹⁴ Although these statements were made during the course of the Tenth Circuit's commercial loan analysis, the court's view of the Board's regulatory role presumably affected its holding on the demand deposit as well as on the commercial loan portion of revised Regulation Y. In any event, the Tenth Circuit's *First Bancorporation* decision—which specifically addressed a Board demand deposit ruling—failed even to suggest that the Board has special expertise in interpreting the BHCA.

In *Board of Governors v. First Lincolnwood Corp.*, 439 U.S. 234, 243, 245 (1978), this Court specifically rejected the contention that the Board's statutory role is limited to a consideration of competitive matters. To the contrary, the Court has noted that Congress "committed to the Board the primary responsibility for administering the BHC[A]" (*Securities Industry Ass'n*, No. 83-614, slip op. 8), so that the Board's interpretation of any of the Act's provisions "is entitled to the greatest deference." *Board of Governors v. Investment Company Institute*, 450 U.S. 46, 56 (1981) (footnote omitted). Indeed, the Court has suggested that the Board's "judgment should be conclusive upon any matter which * * * is open to reasonable difference of opinion." *Id.* at 56 n.21, quoting *Board of Governors v. Agnew*, 329 U.S. 441, 450 (1947) (Rutledge, J., concurring).

The court of appeals' novel proposition that deference is not due the Board when its administrative rulings relate to the scope of its jurisdiction, moreover, is flatly inconsistent with this Court's general teachings on the role of administrative expertise. See *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, No. 82-1005 (June 25, 1984), slip op. 4-7. Whatever the effect of regulatory action on the administering agency, the administrative views are given special weight because they are grounded on the agency's familiarity with the statutory purpose and the intricacies of the regulatory scheme. See *id.* at 6-7. Thus, deference is particularly appropriate in a case—such as this one—that turns on the meaning of undefined statutory terms. See, e.g., *Unemployment Compensation Comm'n v. Aragon*, 329 U.S. 143, 153 (1946); *NLRB v. Hearst Publications, Inc.*, 322 U.S. 111, 131 (1944).

Here, Congress has authorized the Board to "issue such regulations and orders as may be necessary to

enable it to administer and carry out the purposes of [the BHCA] and prevent evasions thereof." 12 U.S.C. 1844(b). Given the form of this delegation of authority, "the validity of a regulation promulgated thereunder will be sustained so long as it is 'reasonably related to the purposes of the enabling legislation.'" *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 369 (1973), quoting *Thorpe v. Housing Authority*, 393 U.S. 268, 280-281 (1969). The revised Regulation Y—which manifestly does further the purposes of the BHCA—falls squarely within this principle.

2. By blocking the Board's attempts to stem evasion of the BHCA's requirements through use of the nonbank bank mechanism, the court of appeals' decision will have an immediate and profound effect on the nation's banking system. Almost 170 nonbank banks already have been chartered.¹⁶ If the Tenth Circuit's decision is left intact, there is little doubt that this number will increase at an accelerating rate: more than 200 additional applications are pending before the Board or the Comptroller of the Currency, and there is no reason to believe that this tide will abate in the absence of Board regulation. Cf. App., *infra*, 24a-25a. In addition, almost 100 industrial banks—which in recent years have begun offering NOW accounts and making commercial loans (see *id.* at 24a, 42a), and thus functioning like commercial banks—now offer services that place them within the ranks of nonbank banks, and many more may soon follow suit. See *Competitive Equity in the Financial Services Industry: Hearings Before the Senate*

¹⁶ The figures involving the numbers of chartered and operating nonbank banks have been provided by the Board; they take account of applications submitted to and acted upon by the Comptroller of the Currency.

Comm. on Banking, Housing, and Urban Affairs, 98th Cong., 2d Sess. 1638, 1644 (1984).

This creation of a large and growing class of banking institutions that are not regulated under the BHCA will change the face of banking in the United States. The majority of nonbank institutions are part of interstate enterprises, meaning that the nonbank phenomenon for the first time permits the largely unrestricted growth of interstate banking networks. This development, the Board found (App., *infra*, 28a), will lead to increased concentration of banking resources, while distorting the balance between state and federal bank regulation struck by Congress in 12 U.S.C. 1842(d)—a consideration that has led at least nine states to protest the establishment of nonbank banks within their boundaries.¹⁶

Similarly, approximately 60 nonbank banks now are owned by institutions other than traditional bank holding companies, including insurance, commercial, securities and industrial firms (App., *infra*, 24a n.7).¹⁷ Such companies also have approximately 40

¹⁶ Within the last year, three states—Colorado (Colo. Senate Bill 47 (Jan. 30, 1985)), Florida (Fla. Stat. Ann. § 658.29(1) (West 1984)), and North Carolina (N.C. Gen. Stat. § 53-229 (1984))—have enacted legislation prohibiting out-of-state bank holding companies from acquiring nonbank banks in those states. Banking officials in Ohio, Tennessee and New Jersey have urged the Board not to approve the formation of nonbank banks within their borders (see App., *infra*, 62a-71a), while officials in three other states (Texas, Iowa and North Dakota) have announced their opposition to the creation of nonbank banks. See *Texas Warns It Will Sue to Keep Nonbank Banks Out of the State*, *American Banker*, Nov. 8, 1984, at 2.

¹⁷ These include institutions such as Sears, Roebuck & Co.; J.C. Penney & Co., Inc.; Shearson/American Express, Inc.; Dreyfus Corp.; Merrill Lynch & Co., Inc.; Prudential-Bache

applications for nonbank banks pending. The continuation of this trend will to a large degree obviate the BHCA's time-honored dichotomy between banking and commerce, while placing traditional bank holding companies—which continue to be regulated by the BHCA—at a severe competitive disadvantage. See App., *infra*, 27a.

These far-reaching consequences of the court of appeals' decision—which will have a nationwide impact—indicate that review of the nonbank bank issue by this Court is warranted at this time. Unless the status of the nonbank bank is resolved soon, the rapid proliferation of such institutions will settle the issue by default: even if the Board's position were to prevail at some time in the indefinite future, dismantling the vast numbers of new nonbank banks would present severe practical problems, while permitting those institutions to continue in operation would introduce substantial competitive inequities into the banking system.¹⁸

Securities, Inc. and similar entities. See American Banker, Oct. 31, 1984, at 16-17.

¹⁸ The nonbank issue also has attracted considerable legislative interest. The BHCA's definition of a bank was last modified in 1982 (see Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 333, 96 Stat. 1504, 12 U.S.C. 1841(c)), when federally-insured savings and loan institutions were excluded. In the last session of Congress the Administration and the Board joined in supporting an omnibus banking bill that, among other things, would have closed the nonbank loophole by defining as a bank within the meaning of the BHCA all federally-insured banks. That bill (S. 2851) passed the Senate by a vote of 88-5, but was not acted on by the House. It is anticipated that the Administration and the Board will renew their legislative efforts during the current session of Congress; three bills have been introduced in the current session that address the nonbank loophole.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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Federal Reserve System

I authorize the filing of this Petition.

LAWRENCE G. WALLACE
Acting Solicitor General *

FEBRUARY 1985

See H.R. 15, 99th Cong., 1st Sess. (1985); H.R. 20, 99th Cong., 1st Sess. (1985); H.R. 428, 99th Cong., 1st Sess. (1985). There is no assurance that legislation will in fact be forthcoming, however, and when adopting revised Regulation Y the Board concluded that in the absence of regulatory action the proliferation of nonbank banks would "preempt Congressional discretion to determine the proper delineation between banking and commerce" (App., *infra*, 22a). We will, of course, keep the Court advised of significant legislative developments in this area.

* The Solicitor General is disqualified in this case.

APPENDIX A

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

83-2696, 84-1011, 84-1122,
84-1257, 84-1270, 84-1407

DIMENSION FINANCIAL CORPORATION, DANIEL T. CARROLL, HAROLD D. DUFEK, WILLIAM L. MITCHELL, RONALD L. SHAFFER, A. GARY SHILLING, STATE OF OHIO, OHIO DIVISION OF SAVINGS AND LOAN ASSOCIATIONS, OHIO DEPOSIT GUARANTEE FUND, HORIZON SAVINGS AND LOAN COMPANY, HORIZON SERVICE CORPORATION, PERMANENT SAVINGS AND LOAN ASSOCIATION, FINANCIAL INSTITUTIONS ASSURANCE CORPORATION, FIRST BANCORPORATION, COLORADO INDUSTRIAL BANKERS ASSOCIATION, FORT LUPTON INDUSTRIAL BANK, MONROE INDUSTRIAL BANK, CASTLE ROCK INDUSTRIAL BANK, ARK VALLEY INDUSTRIAL BANK, HOUSEHOLD WELD COUNTY INDUSTRIAL BANK, HOUSEHOLD LAMAR INDUSTRIAL BANK, HOUSEHOLD ALAMOSA INDUSTRIAL BANK, HOUSEHOLD VALLEY INDUSTRIAL BANK, HOUSEHOLD SALIDA INDUSTRIAL BANK, COPPER STATE THRIFT & LOAN COMPANY, and COPPER STATE FINANCIAL CORPORATION, PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM, RESPONDENT

AMERICAN FINANCIAL SERVICES ASSOCIATION and
HOUSEHOLD FINANCE CORPORATION, INTERVENORS

(1a)

On Petition For Review Of A Regulation Of The
Board of Governors Of The Federal Reserve System

[Filed Sept. 24, 1984]

Before SETH, DOYLE and SEYMOUR, Circuit
Judges.

SETH.

This is a Petition for Review of changes made by the Board of Governors of the Federal Reserve System in Regulation Y (12 C.F.R. Part 225-1983) as it defines which financial institutions are "banks" and thus come under the Bank Holding Company Act (12 U.S.C. §§ 1841-50). The acquisition of a "bank" requires prior approval by the Board of Governors and the company which acquires a "bank" becomes a "bank holding company" subject to the Act. A "bank holding company" is a company which has control over any "bank." 12 U.S.C. §1841(a)(1). What was a "bank" in the original Act depended on its charter. Since the enactment of the Holding Company Act the definition of a "bank" has been narrowed by several statutory changes.

In 1966 the charter test was abandoned and a "bank" was defined as an institution which accepted deposits which "the depositor has a legal right to withdraw on demand." The Board agreed with the change. Then in 1970 the BHC was amended further to provide that a "bank" was an institution which accepted deposits "which the depositor has a legal

right to withdraw on demand" (as before), but added "and engages in the business of making commercial loans." (12 U.S.C. § 1841(c)) The definition was thus narrowed to require that both the deposit and commercial elements must be present to constitute a "bank." It is pursuant to this statutory provision or definitions that the Board argues it proceeded in its changes of Regulation Y with which we are here concerned. The Board's changes redefined the demand and the commercial loan components of the statutory provisions. The statute states what sort of demand deposits are to be used but as to loans only says "engages in the business of making commercial loans."

The new and challenged Regulation Y defines "commercial loans" in 12 C.F.R. part 225, § 225.2:

"(B) 'commercial loans' means any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds."

The challenge by petitioner goes to the inclusion of the "other than" transactions as commercial loans.

The purpose of the Bank Holding Company Act, as amended, is stated in S. Rep. No. 1084, 91st Cong., 2d Sess., *reprinted in* [1970] U.S. Code Cong. & Ad. News 5519, 5541.

This review concerns, with the changes in Regulation Y, both the demand deposit element of the definition in the new Regulation Y and the definition of "commercial loans" therein.

We have considered in *First Bancorporation v. Board of Governors*, 728 F.2d 434 (10th Cir.), the demand deposit aspect in the context of an order directed to one or two institutions and also generally. There would seem to be no need to repeat or add to what was there said and we adhere to that opinion.

The matter of the Board's new and changed view as to what constitutes a "commercial loan" under the 1970 Amendment (the Act) requires some further consideration.

I. "Commercial Loans"

The definition of "commercial loans" since 1970 was developed by regulatory agencies in determinations that particular transactions were *not* commercial loans under the Act. These exclusions have been explained by comparisons with the attributes of transactions generally accepted in the business as commercial loans. The rationalizations are not as important for our purposes as are the conclusions which were reached. This appeal in large part is concerned with money market and interbank transactions which heretofore were not considered to be commercial loans and which are defined as such by changes in Regulation Y.

There is no serious dispute that the term "commercial loan" was in common use and had a generally accepted meaning in 1970 both in the business and by all regulatory authorities, including the Board. There has been no change of this meaning in the business since that time, none evidenced by Congress, and no change by the regulatory agencies except the Board. The Board is thus alone in its new position and this is understandable because it was adopted with no reference to the actual meaning, but instead was

adopted purely to carry out a new Board policy—to *stop changes* in the business of providing financial services—thus to bring a large number of additional enterprises under its jurisdiction by a change in definitions and so as to accomplish this halt to change. In short, the new definition had nothing to do with the original meaning of the term nor the then current meaning, but instead was a device to accomplish an end—a change in the Board's jurisdiction. It was a device to freeze the changes in the business of financial services until the Board could persuade Congress to act. Congress had theretofore declined to adopt a moratorium proposed by the Board on changes which would also have used new definitions to accomplish the purpose. However, as a practical matter, with the new definitions there was more than a halt. It was to cause pervasive changes, thus to cause existing businesses to suddenly become bank holding companies and to necessitate reversal of acquisitions and to bring about divestitures; to change the investments permitted of state chartered savings and loans; and to have other consequences on existing business. It affected other regulatory agencies. For example, the changes required federal deposit insurance for entities which had insurance under state funds and other funds. It required entities to obtain such insurance which were not eligible for it. In short, the changes in definitions and the jurisdiction of the Board would cause extensive changes by other agencies and of course by some entities providing financial services to the public.

II. The Board since 1970 has taken a position on the relation of the Bank Holding Company Act to institutions engaging in all significant money market and interbank transactions. In each instance before

1982 the opinion or advice or ruling was that the transaction was not a commercial loan under the Act. Thus in a 1972 letter to the Federal Reserve Bank of Boston the Board, in reference to the Boston Safe Deposit Company, stated the sale of federal funds was not a commercial loan under the Act nor was the purchase of bankers' acceptances, certificates of deposit, or commercial paper. In 1976 the Board ruled that broker call loans were a passive medium of investment with no close lender-borrower relationship as existed with commercial loans under the Act. In 1980 the Board's Legal Division in a letter to the Federal Reserve Bank of Boston stated that the purchase on the secondary market of the guaranteed segment of SBH and Farmer's Home loans was not commercial lending.

In 1981 an internal memorandum (February 10, 1981) stated that the purchase of money market funds including certificates of deposit, bankers' acceptances and commercial paper were not commercial loans, nor were the purchases of federal funds nor were brokers' call loans commercial loans under the Act.

Later in 1981 the Board again evidenced the existence of its position expressed in the instances referred to above. In this transaction Associates First Capital Corporation purchased the Fidelity National Bank of Concord, California. Associates Corporation was owned by Gulf & Western, a nonbank corporation. The bank divested itself of its commercial loans. However, it remained in the money market and engaged in interbank transactions and the Board was of the view that these did not constitute commercial loans and Fidelity was not a "bank" under the Act.

What may fairly be described as the consistent policy or position of the Board described briefly above

came to an end in December 1982. The Dreyfus Corporation considered the purchase of a nonmember state bank (Lincoln) insured by the FDIC. The proposal was to have the bank cease making commercial loans and to have it divest itself of such existing loans. The Board responded that Lincoln would nevertheless be a "bank" under the Act because in the Act the term "commercial loans" included the purchase of

"commercial paper, bankers acceptances, and certificates of deposit, the extension of broker call loans, the sale of federal funds, the deposit of interest bearing funds and similar lending vehicles."

In Dreyfus the FDIC disagreed with the new position of the Board and permitted the acquisition of Lincoln under the conditions described. The FDIC in a letter of December 29, 1982 from the Deputy Chairman commented that the Board had "dramatically recast the definition of commercial loan," and the FDIC "was constrained to follow the clear legal precedents established over the years," and further commented that a change as expressed by the Board should be brought to the attention of Congress and not handled by agency action.

Also in Dreyfus the Comptroller as to a separate charter application stated "that the inclusion of money market transactions within the BHCA term 'commercial loans' is not supported by the purpose or the legislative history of the BHCA," and referred to the Boston Safe matter. The Comptroller described as the money market transactions referred to were essentially a passive medium of investment and involved no close lender-borrower relationship and thus

did not constitute a threat of the abuse sought to be met by the Act.

The Board Dreyfus letter (December 1982) was followed in May of 1983 by the Board's notice of the proposed changes in Regulation Y here considered. The changes by Regulation Y must be characterized as a complete "reversal" of the Board's previous position. The change was from white to black, from no to yes. It was not a modification or variation on the previous position nor did it seek to fill in some sort of gap. Money market transactions on one day were not commercial loans and the next day they were. This in itself does not sound so drastic, but the consequences sought to be visited thereby on a variety of financial institutions and their long-standing relationships and the regulatory authorities were indeed drastic. No party contends that the new definition is in accord with common usage.

III. The purpose of the reversal of position by the Board was, as already described, to stop the changes which were proceeding at a fast pace in businesses providing financial services. In order for the reversal to be effective the Board's authority had to be and was expanded to include institutions not theretofore within its jurisdiction as to all, or as to substantial parts of their activities. As also mentioned, this expansion of jurisdiction was very much more than just the prevention of future acquisitions, arrangements or affiliations. It was to cause divestitures of old acquisitions, sale of assets, changes in permitted uses of excess funds by state chartered and other institutions. It also was to have a drastic impact on many other types of business arrangements and on the way business was conducted, who could insure deposits and changes in regulatory authority from states to the "feds."

Such a complete change and one which is a redefinition and expansion of jurisdiction by an agency requires that different standards be met than are demanded in a typical administrative redefinition not involving such elements.

One additional factor present here is the reason why the change was made. The departure from the accepted meaning or general usage prevailing at the time Congress passed the Act was not a consequence of any original error; nor of any change in trade usage; nor as a result of any signal from Congress; nor to coincide with the views of other regulatory agencies. Instead the change was to provide, by an expansion of jurisdiction, a regulatory device to change the course of the development of financial institutions which had taken place in conformance with the Act as construed by the Board from the outset. The Board since 1970 thus gave strong signals as to the definitions which created exceptions to the Act. The Gulf & Western decision was one of several such signals.

The new kinds of institutions which grew in number under the statutory-administrative provisions were well within the permitted exceptions, some formally approved, and cannot be considered as departures nor as evasions of the Act. A permitted exception cannot now be classified as an evasion as the Board would argue.

IV. The Act itself with the clearly expressed definitions permitted the development of the non-bank banks. The exceptions created by the definitions were based on industry usage, as mentioned, and contemplated that *some* institutions would not be included. An example is Boston Safe which was brought to the attention of the Senate by Mr. Robertson, head of the

Board. The Board obviously knew what Boston Safe was doing. The statute thus anticipated exceptions, but apparently no one anticipated that the pressure for change in financial services would be as great and the business so volatile as it was in the years following. The problem has come not from the scope of the intended exceptions nor from the validity of the definitions, but from the prediction as to the numbers or volume within the exceptions. A prediction which probably no one could have accurately made, and the resulting problem, if it is that, could have been (or could be) resolved only by Congress should it perceive a need to act as in 1956, 1966 and 1970.

The changes which have come about cannot be characterized as "evasions" of the Act. The entities have followed the Act, and have followed the interpretation by the agency. There is nothing before us to indicate any violations of the regulations, and the Board has pointed out none. Early on in Boston Safe a strong signal was given as to what was permissible, and as late as Gulf & Western the Board demonstrated what still could be done. It is difficult to understand how the latter could be characterized as an "evasion."

V. Legislative History

The legislative history of the 1970 Amendment contains an unusual and significant element. This is again the Boston Safe Deposit & Trust Co. application which was apparently pending at the time the Senate was considering the 1970 Amendment (the Act). To repeat, Mr. Robertson of the Board then advised the Senate committee that the 1970 Amendment would have a limited impact and this would

"include" the Boston Safe Deposit & Trust Co. This "impact" was the fact that Boston Safe would not be a "bank" as it would be excluded by the term "commercial loans" in the Act. The Board, of course, knew of the transactions Boston Safe sought to engage in (or was then engaging in), and these were demand deposits and the typical money market and interbank transactions. It apparently also assumed that the Senate committee also knew. These as described above were then not considered in the business as "commercial loans." The Board stated that it did not consider them as included in the term "commercial loans" and so advised the Senate committee. To repeat, the Board was of the view that Boston Safe was not a bank.

It seems to have been agreed that the 1966 definition of a "bank" was too broad and to narrow the exceptions some reference to loans should be made. In S. Rep. No. 1084, 91st Cong., 2d Sess., *reprinted in* [1970] U.S. Code Cong. & Ad. News 5519, 5541, the Senate committee indicated that the then existing definition was intended "to include commercial banks and exclude those institutions not engaged in commercial banking" as the Bank Holding Company Act was designed to prevent the misuse of commercial bank credit and the concentration of control over commercial banks. The Board then agreed that the 1966 definition might include institutions which were not in the commercial banking business—that is did not make commercial loans. The 1970 Amendment thus excluded financial businesses which did not make such loans.

There can really be no serious dispute but that the term "commercial loans" as used in the banking business when the Act was adopted did not include the

purchase of money market transactions nor certificates of deposit nor did it include interbank transactions.

The position taken by several of the Federal Reserve Banks and by the FDIC and the Comptroller contrary to that of the Board, and the reasons such regulatory agencies have expressed, demonstrate the accepted meaning then and now of the term "commercial loans."

The purchases added by the Board are for the most part open market transactions—purchases on a secondary market—where prices are set not by the parties but by all market transactions. The Board has shown no facts which would show abuses contemplated by the BHCA in commercial banking by those engaging in money market transactions.

VI. The Board under the BHC Act has authority to make rules and regulations. Under Section 5(b) of the Act (12 U.S.C. § 1844(b)) the Board is authorized to issue orders and regulations "as may be necessary to enable it to administer and carry out the purposes of this chapter and to prevent evasions thereof."

The authority of the Board under the Act is to be exercised in a restricted area. It does not have the broad scope to work in as do many other agencies. There is not present a "public good" or "public benefit" provision. Instead, the BHCA limits the subject matter of the Board's functions basically to anticompetitive considerations.

This matter was discussed by this court in *Western Bancshares, Inc. v. Board*, 480 F.2d 749 (10th Cir.), where the Board had disapproved an acquisition because the same price was not paid for all shares. We there referred to the "express factors" in the Act:

"Rather, the thrust of the 1970 amendments is designed to more adequately protect against abuses which may be of future concern on the part of previously exempt one-bank holding companies in addition to certain modifications relating to companies controlling more than one bank. These possible abuses or future concerns related to monopolistic practices, lessening of competition and extension of a line of credit to finance an unrelated business concern over which it had control. By bringing the one-bank parent holding company within the Act, Congress expressed concern only that the Board be allowed to exercise control relating to the express factors above referred to and management policies of the bank in meeting the public need and convenience.

. . . .

"... The selective process of the Board in relying upon the broad maxim or reference to the 'public interest' lends no aid, and in fact blends with confusion in the decisional process here involved. Congress *did not* isolate the terms to fit the Board's fancy. It spelled out the specific factors to be considered by the Board relating thereto. . . . We are not dealing in the broad spectrum of administrative policy delegated by Congress to an agency determinative of 'public interest, convenience, and necessity.' *Public Utilities Commission of the District of Columbia v. Pollak*, 343 U.S. 451, 72 S.Ct. 813, 96 L.Ed. 1068 (1952). Issues as to the reasonableness or inequality of stock purchases must be decided upon the basis of the law of contracts, or such other principles of law as may be applied in a forum competent to adjudicate the issue between

the parties thereto. Contemporaneous construction of a statute by an agency charged with its enforcement is entitled to great deference by the courts. *Griggs v. Duke Power Co.*, 401 U.S. 424, 91 S.Ct. 849, 28 L.Ed.2d 158 (1971). But we are not bound thereby, and particularly so where neither the Act nor the legislative history contains one word expressly permitting the administrative authority assumed." (Emphasis in original.)

The court in *Patagonia Corporation v. Board*, 517 F.2d 803 (9th Cir.), considered a prior position taken by the Board on other applications, and said:

"These inconsistent prior adjudications, which are among the very few previous examples of the Board's prior consideration of the controlling influence tests, indicate that the position that the Board advances with respect to *Patagonia* is not the type of consistent, clearly articulated administrative interpretation of a statute with which the courts are generally reluctant to interfere."

Also of significance the court in *Patagonia* also considered the narrow scope of the Board's function and of this said:

"It is of interest to note that under the Act, the Board's administrative mandate is not open ended. Congress did not write the Act in general terms, thus leaving extensive areas of law to be developed by the Board. Rather, the Board is charged with responsibility for administering relatively specific statutory provisions. See *Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749, 753-54 (10th Cir. 1973); 15 B.C. Ind.

& Com.L.Rev. 369 (1973). Congress surely did not intend that the Board would be empowered to expand or constrict the statutory definition of 'subsidiary' or the grandfather proviso, the scope of which Congress carefully considered, in accordance with the Board's conception of regulatory needs. That the Board's mandate under the Act is relatively circumscribed is also relevant in determining the extent to which courts must defer to the Board's interpretation of the Act."

In *Garvey v. Freeman*, 397 F.2d 600 (10th Cir.), this court considered administrative interpretations and we there quoted from *Stark v. Wickard*, 321 U.S. 288, 309-310, as follows:

" 'When Congress passes an Act empowering administrative agencies to carry on governmental activities, the power of those agencies is circumscribed by the authority granted. * * * The responsibility of determining the limits of statutory grants of authority in such instances is a judicial function entrusted to the courts by Congress by the statutes establishing courts and marking their jurisdiction.' "

The Supreme Court in *Board of Governors v. First Lincolnwood Corp.*, 439 U.S. 234, in the application of a financial soundness test found specific statutory authority for the Board's act. The Third Circuit in *Wilshire Oil Co. v. Board of Governors*, 668 F.2d 732, considered an obvious attempt, by changes in terms of demand deposits, to evade the Act's definition of deposits. This represents a significant decision on evasions of specific provisions of the Act.

There is a related doctrine which must be considered when an agency radically changes its position

on statutory construction. In such circumstances the agency must clearly articulate the basis for the change. This is not only an aspect of any procedural notice requirement in rulemaking but is a substantive need. The Supreme Court in *Motor Vehicle Manufacturers v. State Farm*, — U.S. —, 103 S.Ct. 2856, 51 U.S.L.W. 4953, mentions this requirement. The articulated facts must show a purpose for the change well within the agency authority.

It is, of course, necessary that the regulatory authorities be able to change to meet new conditions arising within their sphere of authority *and* for a purpose or to accomplish a result within their authority. The Court in *American Trucking, Inc. v. AT&SF R. Co.*, 387 U.S. 397, very clearly enunciated this proposition.

VII. The doctrine which accords deference to regulatory agencies in their implementation of statutory provisions has been thoroughly developed and needs no discussion here. This court has recognized it as quoted herein and we do so now. The application of the doctrine assumes that the regulatory authority is acting on a matter within the subject matter scope of its statutory duties. It also assumes that the action has been taken to carry out the particular purpose of the statute and not to meet other conditions, related or not, that the agency decides should be changed or regulated. Instead, such action requires a change in the jurisdiction of the agency by Congress.

It must be recognized that the statute here concerned is of very narrow scope and the Board necessarily operates within these limitations. Likewise the statute has a clearly recognized purpose and again the actions of the Board are confined to the accomplishment of this purpose. "Expertise" in this con-

text can only mean the skill and experience of the agency within its proper scope of activity.

We cannot hold that the limited authority of the Board permits it to itself bring about the change here attempted and a change in its own jurisdiction no matter how necessary it perceives the change to be, and no matter how serious it may consider the inaction of Congress to be in the face of the growth of financial institutions presently outside the Board's statutory jurisdiction.

We are concerned about the positions contrary to that taken by the Board expressed by the Comptroller of the Currency and the Federal Deposit Insurance Corporation which are regulatory agencies in the same field and with some overlapping functions. We also note the contrary views of several regional Federal Reserve Banks. The Federal Reserve Bank of Atlanta stated as to changes in the Board's position, "Since the new definition of commercial loans has no basis in tradition or in the BHC Act it appears to provide an overly broad extension of the regulation." The Federal Reserve Bank of San Francisco stated it was "not convinced that the Board's expansive reading of 'bank' is justified, or that Congress intended that so-called 'nonbank banks' be subject to Board authority under the Bank Holding Company Act." The Federal Reserve Bank of Chicago expressed a similar view.

VIII. It does not appear necessary to discuss how the assertion of authority to control the use of excess or investment funds will affect state institutions. We do not comment on the distinctions made between NOW accounts and demand deposits in the Garn-St. Germain Act (Pub. L. No. 97-320), nor do we feel it necessary to discuss the Douglas Amendment although

it is a significant factor in the mix of state and federal regulation.

The possible exception to the initial impact of Regulation Y (Part 225.21(B)(4)) contains requirements with no objective standard and completely with agency discretion. This as a device to meet objections to the new regulation cannot cure the exercise of powers denied by Congress or not provided for by Congress. *Public Utilities Comm. of Calif. v. United States*, 355 U.S. 534; *In re Surface Mining Regulation Litigation*, 627 F.2d 1346 (D.C. Cir.).

The Act expressly requires the Board to annually make recommendations to Congress as to changes in the law which it feels desirable. 12 U.S.C. § 1844(d).

We have carefully considered the Appendix which accompanied the changed Regulation Y when it was issued. It contains the Board's view of the need for changes and states the Board's conclusions as to several conditions it perceived to exist.

The petitioner asserts that facts were not presented in advance of the adoption of the changes to an extent that any meaningful comments could be made as required by the APA. *See Texaco, Inc. v. F.P.C.*, 412 F.2d 740 (3d Cir.), and thus faults the adoption of the changes. We, however, express no opinion on this point.

As mentioned at the outset, there would seem to be no need to again cover the demand deposit element in the changes. We decided this matter in *First Bancorporation v. Board of Governors*, 728 F.2d 434 (10th Cir.). We abide by that decision which is fully applicable to the same issue now before us again.

The order and rule of the Board adopted on December 29, 1983 which amended the then existing Regula-

tion Y (12 C.F.R. Part 225-1983) are hereby set aside. IT IS SO ORDERED.

IT IS FURTHER ORDERED that the Board shall not attempt to enforce or implement such changes herein held invalid. The mandate shall issue in the usual manner.

APPENDIX B
SUPPLEMENTARY INFORMATION,
APPENDIX A

[49 Fed. Reg. 833-842 (1984)]

The proposed revision of Regulation Y included the following definition of "bank":

any institution organized under the laws of the United States that accepts demand deposits and engages in the business of making commercial loans.

This definition essentially reiterates the two-pronged definition of bank in section 2(c) of the BHC Act, which defines a "bank" as "any organization . . . which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans."¹ The bank definition is the key to the Act because it supplies the basis for effecting the fundamental purposes for which the legislation was enacted: (1) the separation of the business of banking from commerce to assure impartiality in the granting of credit and avoidance of conflicts of interest; (2) the limitation of risk to the banking system inherent in the unlimited association of banking and commerce; and (3) the prevention of concentration of banking resources.

In order to clarify the coverage of the bank definition consistent with these policies, the Board has in-

¹ 12 U.S.C. § 1841(c). There are a number of statutory exemptions to this definition, e.g., for FSLIC insured thrift institutions.

terpreted the terms "deposits that the depositor has a legal right to withdraw on demand"² and "commercial loans" in section 2(c) of the Act. In approving an application by a bank holding company under the Act to acquire an industrial loan company that offered NOW accounts and made commercial loans, the Board interpreted the phrase "deposits that the depositor has a legal right to withdraw on demand" in section 2(c) of the Act to include NOW accounts. *First Bancorporation (Beehive Thrift and Loan)*, 68 Federal Reserve Bulletin 253 (1982).

Similarly, in reviewing a proposal to acquire an FDIC insured state bank by The Dreyfus Corporation, a nonbanking organization engaged in the underwriting and sale of securities, the Board reiterated its view that the term commercial loan in section 2(c) of the Act means any loan the proceeds of which are used for other than personal, family, household, or charitable purposes. The Board also determined that, for this purpose, commercial loans include the purchase of commercial paper, bankers acceptances, and certificates of deposit, and the sale of federal funds and other transactions that establish a debtor-creditor relationship. Letter of December 10, 1982, to the FDIC.

The proposed amendments would incorporate the Board's interpretations into Regulation Y. A number of commenters opposed the definitions. The Independent Bankers Association favored the definitions, and the American Bankers Association supported the proposed definition of "commercial loan."

After careful consideration of the comments, the Board has determined to adopt the "bank" definition

² Hereinafter "demand deposit."

with minor modifications, including its interpretations of the terms demand deposit and commercial loan. The Board believes that these interpretations are both necessary and appropriate to carry out the fundamental purposes of the Act. In the Board's judgment, any other interpretation of these important terms would produce a result that is plainly at variance with the purposes of the Act and would preempt Congressional discretion to determine the proper delineation between banking and commerce in this country as well as the scope for interstate banking. The Board's interpretation of the bank definition is directed towards this end, consistent with its authority under section 5(b) of the Act to issue rules and regulations.

As originally enacted, the BHC Act defined "bank" as "any national banking association, or any State bank, savings bank, or trust company. . . ." In 1966, Congress eliminated this charter test in favor of the functional demand deposit test. The legislative history of these amendments indicates that Congress intended to cover all checking accounts as demand deposits and did not intend to exempt from the definition of "bank" institutions that function like banks. Congress viewed the ability to offer checking accounts as critical in determining whether an institution meets the "demand deposit" portion of the Act's definition of bank and intended demand deposits to include all checking accounts.

In 1970, Congress again amended the Act by adding a second requirement for bank status: that the institution also be engaged in the business of making commercial loans. The Board did not propose the amendment in 1970, which limited the definition of bank to those institutions that accept demand de-

posits and make "commercial loans," although the Board offered no objection to the amendment because it was intended to be narrow in scope, possibly exempting only a single company—Boston Safe Deposit and Trust.³ The Board's view is reflected in a letter from Federal Reserve Board Chairman Burns to Chairman Sparkman of the Senate Banking and Currency Committee:

" . . . S. 3823 would amend the definition of "bank" to exclude banks that make no commercial loans. To the best of our knowledge, this amendment would have very limited application at present, possibly affecting only one institution. Since there is less need for concern about preferential treatment in extending credit where no commercial loans are involved, and in view of the very limited application of this amendment, the Board would have no objection to its adoption."⁴

The House conferees agreed to the change of the definition of "bank" (not present in the House passed bill), but the majority of the House conferees cautioned that the Board should construe the 1970 exemptions from the Act "as narrowly as possible in order that all bank holding companies which should

³ 116 Congressional Record S. 6908, 6911 (daily ed. May 11, 1970); 116 Congressional Record H. 7207 (daily ed. July 27, 1970); 116 Congressional Record S. 20642 (daily ed. December 18, 1970).

⁴ One Bank Holding Company Legislation of 1970: Hearings on S.1052, S.1664, S.3823; and H.R. 6778, Before the Senate Committee on Banking & Currency, 91st Cong., 2d Sess. 137 (1970).

be covered under the Act in order to protect the public interest, will, in fact, be covered.”⁵

These modifications to the definition of bank in the Act were designed to exclude from coverage under the Act savings banks, trust companies and industrial banks.⁶ In both 1966 and 1970, savings banks, trust companies and industrial banks bore little resemblance to commercial banks because these three types of entities did not have bank charters or their activities were confined to fiduciary activities, the taking of savings and time deposits, and the making of home mortgages and consumer loans.

Between 1970 and 1981, the exemption remained within the narrow confines intended by Congress. However, since 1980, the powers of industrial banks have substantially expanded and they are eligible for FDIC insurance, making them for all intents and purposes banks. More importantly, a large number of insurance, securities, industrial and commercial organizations have acquired FDIC insured national or state banks.⁷ These acquisitions have been accomplished through the device of divesting a portion of the acquired bank's commercial loan portfolio and continuing to accept demand deposits or through giving up the taking of demand deposits but continuing to make commercial loans. Both techniques are premised on a narrow interpretation of the terms

⁵ Statement of the Managers on the Part of the House, H. Rep. No. 1747, 91st Congress, 2d Sess. 23 (1970).

⁶ S. Rep. No. 1179, 89th Cong., 2d Sess. 7 (1966); S. Rep. No. 91-1084, 91st Cong., 2d Sess. 24 (1970).

⁷ Since 1980, there have been a number of acquisitions of insured banks by insurance, securities, commercial and industrial companies.

demand deposits and commercial loans in section 2(c) of the Bank Holding Company Act.

These so-called “nonbank banks” acquired through this device continue to take deposits from the public, to make loans, to enjoy the benefits of discount window access and federal deposit insurance, and to have access to the payments system.¹ They remain for all practical purposes banks, but are not subject to the prudential limitations that Congress deemed essential when banks are affiliated with commercial enterprises. Indeed, the charter powers of a “nonbank bank” are identical to those of a full service commercial bank—and it is only different to the extent that the nonbank bank *voluntarily* chooses not to offer commercial loans or demand deposits under a narrow definition of those terms.

Acquisitions of this nature and in the numbers that have occurred were not contemplated by the 1970 Amendments. As noted above, the Board advised Congress that it believed the exemption would be of “very limited application,” and the House Conferees admonished the Board to construe the exemption “narrowly.” Such a construction is consistent with the broad expansion of the Act's coverage accomplished by the 1970 Amendments to encompass partnerships, one bank holding companies, and control relationships based on a controlling influence. Indeed, the desire to prevent evasion of the Act's purposes in 1970 was sufficiently pervasive for Congress to reject a proposed exemption for very small banks which had no more than \$3 million in net worth.⁸ It is inconsistent with the Congressional intent as expressed in the Act to suggest that at the same time Congress substan-

⁸ Statement of The Managers on the Part of the House, *supra* at 23.

tially expanded the Act's coverage to ensure the separation of banking and commerce, it took the significant step, almost without debate, of creating a new class of depository institution that could be acquired by all types of nonbanking organizations.

The primary impetus for the 1970 Amendments were two events that occurred in the late 1960s. First, the largest banks in the nation sought to use the then existing one bank holding company exemption to form holding companies and commence various nonbanking activities, at times through the acquisition of going concerns such as large insurance companies. At the same time, large nonbanking organizations such as manufacturing firms, insurance companies, and retailers began to acquire single banks. Congress sought to block both of these trends through the 1970 Amendments.⁹ The recent acquisition of banks by large commercial enterprises such as insurance, securities, and industrial companies is completely inconsistent with expressed Congressional intention to prevent such affiliations.¹⁰

In recognition of the unique and critical role that banks play in the nation's financial system and economy with respect to operation of the payments system, as custodians of the bulk of liquid savings, and as suppliers of credit, Congress has provided these institutions with access to the Federal Reserve as a

⁹ Statement of the Managers on the Part of the House, *supra*, at 11; S. Rep. No. 1084, *supra*, at 2-3; Cong. Rec. S 1696 (1969) (Remarks of Sen. Proxmire); Cong. Rec. H 9776-77 (1969) (Remarks of Cong. Patman).

¹⁰ Moreover, many of the "nonbank banks" that nonbanking companies have formed differ significantly from the institution for which the exemption was written, since Boston Safe was primarily engaged in trust company business in 1970.

lender of last resort, and access to federal deposit insurance. However, as a consequence of this special status, banks are subject to prudential limitations designed to limit risk, promote sound operations, assure impartiality in the credit granting process, and prevent excessive concentration of credit resources. The Bank Holding Company Act represents one of the principal mechanisms for accomplishing these goals through its limitations on the commingling of banking and commerce and the concentration of banking resources.

The framework of regulation created by the Bank Holding Company Act is frustrated, however, to the extent that institutions engaged in banking functions are allowed to secure the benefits of bank status while at the same time their corporate parents evade the prudential limitations on the scope of nonbanking activities that Congress established in the Bank Holding Company Act. Moreover, this situation threatens to undermine the system of bank holding company regulation as a whole since bank holding companies that are subject to the Act's prudential limitations are placed at an increasing competitive disadvantage with respect to the securities, insurance, manufacturing and retail companies that own "nonbank banks" and that are free to establish synergistic relationships between their banking and impermissible nonbanking operations.

It has been suggested that these nonbank bank institutions that are chartered as banks are not engaged in demand deposit taking or in direct commercial lending to customers or clients of the bank and therefore the nonbanking activities of their affiliates do not raise the policy concerns that the Act was intended to address. However, as indicated in more

detail below, these banks raise the same prudential problems as other banks and, in fact, the operating techniques used by nonbank banks do amount to the taking of demand deposits and the making of commercial loans. Moreover, the Board is also concerned with the difficulty of assuring the enforcement of a self-imposed limitation on direct commercial lending where, for example, close links associated with common control would be established between the demand deposit-taking function of the nonbank bank and commercial lending activities conducted through separate corporate subsidiaries of the parent organization.

The possibility of "understandings" involving the placing of funds derived from deposit taking by nonbank banks with banking institutions that would agree to take a favorable view toward lending to the nonbank bank's industrial or commercial affiliates would circumvent the purposes of the Act and pose serious enforcement problems. Similarly, as is discussed below, a nonbank bank could lend to consumers on terms aimed at furthering the purchase of goods or services from affiliates of the nonbank banks. The Act was designed to deal with the potential abuses that could result from concentration of resources and/or from conflicts of interest that inherently arise in the common ownership of banks and commercial organizations, and the potential for these abuses is clearly present in the relationship between nonbank banks and their corporate parents and affiliates.

The legislative history of the Act confirms the fact that Congress was concerned about the use of banking powers in tandem with other commercial and industrial enterprises even where these powers were used exclusively for so-called consumer lending. Congress believed that banks exercising these powers

should be covered by the Act to assure impartiality in lending and prevent the cartelization of industry and commerce around banks. The 1970 report of the Senate Committee on Banking and Currency quotes, and indicates agreement with, the following remarks by former Federal Reserve Chairman Martin:

If a holding company combines a bank with a typical business firm, there is a strong possibility that the bank's credit will be more readily available to the customers of the affiliated business than to customers of other businesses not so affiliated. Since credit has become increasingly essential to merchandising, the business firm that can offer an assured line of credit to finance its sales has a very real competitive advantage over one that cannot. . . . [I]f we allow the line between banking and commerce to be eased, we run the risk of cartelizing our economy. Just as we have seen the country's largest banks join the new wave of one-bank holding companies, we could later see the country's business firms clustering about banks in holding company systems in the belief that such an affiliation would be advantageous, or perhaps even necessary to their survival.¹¹

The Congressional concern that banks which were affiliated with other businesses might make loans designed to further the interests of those affiliates is also evidenced in section 4(d) of the Act. This section allows the Board to grant exemptions from the nonbanking prohibitions of the Act for certain companies, including those whose subsidiary banks are

¹¹ S. Rep. No. 1084, *supra*, at 3.

so small "as to minimize the likelihood that the bank's powers to grant or deny credit may be influenced by a desire to further the holding company's other interests." 12 U.S.C. § 1843(d). While Congress was prepared to concede that there could be cases where a bank was so small as not to create a situation that was inconsistent with the basic purposes of the Act, it deliberately avoided a blanket size exemption and instead conferred the exemption judgment exclusively on the Board.

The nonbank bank device allows precisely the conflicts of interest and other adverse effects that Congress sought to prohibit in 1970. A nonbank bank is able to make commercial loans by purchasing such instruments as commercial paper, and it may make all types of consumer loans, in association or in tandem with the operations of its commercial affiliates. Moreover, both types of loans may be made without regard to the anti-tying provisions of the Bank Holding Company Act, 12 U.S.C. §§ 1971-78. These provisions prohibit banks from extending credit or furnishing any service, or fixing or varying the consideration for any such extension of credit or service, on the condition that the borrower purchase some other goods or services from a holding company affiliate of the bank, or on the condition that the borrower not obtain some other credit, property or service from a competitor of the bank's holding company affiliates. 12 U.S.C. § 1972(1).

Congress viewed these anti-tying limitations as necessary for the conduct of the additional nonbanking activities permitted for bank holding companies by the 1970 Amendments because of the possibility that such new activities could lead to a variety of adverse effects such as the tying of credit to other

nonbanking services.¹² Under the Board's regulations, a bank holding company and its nonbank affiliates are similarly prohibited from providing products and services on condition that the customer obtain services from the affiliate bank. 12 C.F.R. § 225.4(c) (1983). Under the narrow interpretation of commercial loan relied on by nonbank banks, not only are the activities of the parent of the nonbank bank unlimited, but the nonbank bank itself is free to require that prospective borrowers buy insurance, securities or other goods and services from those affiliates in order to receive an extension of credit from the nonbank bank. The Board believes that the ability of nonbank banks to engage in such coercive practices in order to provide a competitive advantage for their affiliates creates serious competitive inequalities and significantly undermines the structure designed by Congress for the regulation of the nonbanking activities of banks and their holding company affiliates.

In addition, the proliferation of nonbank banks would allow for the expansion of banking across state lines without either state authorization or Congressional approval as is now required by law. While the Board has supported a Congressional reevaluation of the present ban on interstate acquisitions without state approval, interstate acquisitions of so-called nonbank banks would violate both the letter and clear intent of the Douglas Amendment.

In this context the Board has reexamined its interpretation of the terms demand deposits and commercial loan in light of the comments received from the public.

¹² Statement of the House Managers, *supra*, at 18.

Definition of Demand Deposits.

The final amendments interpret the phrase "deposits that the depositor has a legal right to withdraw on demand" in section 2(c) of the Act as "any deposit with transactional capability that as a matter of practice is payable on demand and that the depositor may withdraw by check, draft, negotiable order of withdrawal, or other similar instrument for payment to third parties."

Several commenters objected to the Board's definition of demand deposits as contrary to the traditional treatment of NOW accounts as savings deposits. These commenters argued that, because institutions offering NOW accounts are required to reserve the right to require 14 days' prior notice of withdrawals, the accounts are not in fact demand deposits. The commenters also objected to the proposed definition as inconsistent with legislative history indicating that certain institutions that currently offer NOW accounts, such as industrial banks and industrial loan companies, were not intended to be treated as banks.

The Board believes, however, that traditional interpretations of the term demand deposits, the regulatory treatment of accounts with transactional capability, the functional equivalency of demand deposits and NOW accounts, and the legislative history and purposes of the Bank Holding Company Act require that NOW and similar accounts be treated as demand deposits for purposes of the BHC Act. The legislative history and purposes demonstrate that the term demand deposits in section 2(c) of the Act cannot be interpreted to turn on the technicality of whether the account is subject to a notice of withdrawal requirement that in practice is never imposed. Such an

interpretation would permit the fundamental purposes of the Act to be circumvented or rendered meaningless simply through the offering of checking accounts that perform the same function as demand deposits, that are advertised as checking accounts, and that for all intents and purposes are the equivalent of a conventional demand checking deposit, but that are not treated as demand checking deposits only because they are subject to a never exercised right of the depository institution to require prior notice of withdrawals. It is a fundamental principle of statutory construction that a statute must be interpreted to give effect to its purposes and to avoid an absurd or unreasonable result. *United States v. American Trucking Association*, 310 U.S. 534, 543 (1940).

Legislative History.

As indicated, the legislative history of the Act reflects that, when Congress eliminated the charter test of "bank" status in 1966 in favor of the demand deposit test, it intended to cover checking accounts, like NOW accounts, as demand deposits and did not intend to exclude institutions that function as banks. In 1963, the Board issued an interpretation regarding the coverage of industrial banking organizations, such as industrial loan companies, under the charter test in the original Act. 49 Fed. Res. Bull. 166 (1963). The Board ruled that industrial banking organizations would be banks for purposes of the Act in two situations: (1) if they issued accounts subject to withdrawal by check; or (2) if in actual practice they permitted a withdrawal of deposits on demand. The second part of this test referred to ordinary passbook savings deposits, which are paid on demand but that are not freely withdrawable by check.

Subsequently, during Congressional hearings on the 1966 Amendments to the BHC Act, representatives of industrial banking organizations requested that certain of these institutions be exempted from the Act on the rationale that industrial banks and similar institutions only made loans to consumers, offered savings certificates, and did not accept checking accounts.¹³ The Board endorsed this proposal on the basis that the BHC Act should cover only institutions that accept demand or checking accounts.¹⁴ In effect, the Board favored repeal of the second part of its 1963 industrial bank interpretation that covered an industrial banking organization if such institutions limited their deposit taking activities to the offering of passbook savings accounts. The Board stressed, however, that the first part of this test should be retained and industrial banks should continue to be covered if they accepted checking accounts.

Congress adopted the Board's proposals by eliminating the charter test in favor of the demand deposit definition. The legislative history is clear that Congress did not intend to repudiate the first part of the Board's 1963 industrial bank interpretation, and that the authority to offer checking accounts was regarded as the fundamental characteristic of a "bank" under the Act. The Senate Report accompanying the amendments expressly stated that the bank definition was intended to include an institution that

¹³ *Amend the Bank Holding Company Act of 1956: Hearings on S. 2353, S. 2418, and H.R. 7371 before a Subcomm. of the Senate Comm. on Banking and Currency, 89th Cong., 2d Sess. 155, 157 (1966) (testimony of Max A. Denney, American Industrial Bankers Association) (hereinafter "1966 Senate Hearings").*

¹⁴ *Id.* at 447.

accepts deposits payable on demand, which the report described as checking accounts.¹⁵ Senator Robertson, the sponsor of the bill, stated that the amendment covered only institutions that "accept demand deposits subject to check" and excluded industrial banks because they did not accept deposits subject to check. 112 Cong. Rec. 11,794 (1966). Nothing in the reports of the relevant committees or in the statements of the bill's sponsor ever refers to a notice of withdrawal requirement as a prime characteristic of the deposits covered by the Act.¹⁶ Based on this legislative history, the Board concludes that Congress did not intend to exclude from the concept of demand deposit checking accounts that are subject to a formal requirement of notice where the instrument functions in all other respects in the same manner as one that is not subject to such a formal notice.

Thus, following the 1966 Amendments, the Act continued to apply to institutions accepting deposits subject to withdrawal by check, but no longer applied to institutions offering deposits, such as passbook savings deposits, that are in practice paid on demand but which are not subject to withdrawal by check or similar device. The United States Court of Appeals for the Third Circuit has recently held that the retention of the right to require advance notice of withdrawal is *not* necessarily determinative of whether a

¹⁵ S. Rep. No. 1179, 89th Cong., 2d Sess. 7 (1966).

¹⁶ While the language adopted in the 1966 Amendments differed from that proposed by the Board ("deposits payable on demand"), there is no indication in the legislative history that this change was intended to be substantive. Indeed, as noted, the Congress consistently referred to the change as encompassing "checking accounts."

particular type of deposit is a demand deposit under the BHC Act:

Congress did not choose the words "accepts deposits that the depositor has a legal right to withdraw on demand" because it was concerned with the distinction between a depositor's *legal* right to withdraw on demand and the ability *in practice* to withdraw on demand. The more reasonable interpretation of why Congress selected these terms is that stated in the [1966] Senate Report . . . Congress was merely adopting "the commonly accepted test of whether an institution is a commercial bank."¹⁷

Administrative Interpretations. The term "demand deposit" has been used in many earlier federal banking laws and over the years had uniformly been interpreted to include any deposit, such as a NOW account, that is withdrawable by check regardless of whether the deposit is subject to a notice of withdrawal requirement. As early as 1915, the Board recognized the right of an institution to require advance notice of withdrawal as a distinguishing factor of a savings account, but made clear that, where a notice account was ordinarily subject to withdrawal by check, that account would be treated as a demand deposit and would be subject to the higher level of reserves applicable to demand deposits. 1 Fed. Res. Bull. 38 (1915).¹⁸ In 1933, the Board, in defining de-

¹⁷ *Wilshire Oil Co. v. Board of Governors*, 668 F.2d 732, 737 (3d Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982) (emphasis in original).

¹⁸ See 1 Fed. Res. Bull. 73 (1915) (savings deposits subject to check); 9 Fed. Res. Bull. 677 (1923) (special savings accounts against which an unlimited number of checks can be

mand deposit for purposes of the prohibition against the payment of interest on accounts payable on demand, included savings accounts subject to withdrawal by check, notwithstanding the fact that the savings account had an advance notice of withdrawal requirement. The Board explained that such action was necessary to prevent evasion of the statutory prohibition since accounts subject to a notice requirement typically pay interest and reflected the Board's view that checkable notice of withdrawal accounts were functionally demand deposits.¹⁹ 21 Fed. Res. Bull. 792, 863 (1935).

Thus, at the time of the 1966 amendment of the "bank" definition to cover demand deposits, that term had a well-defined meaning under longstanding agency interpretation and included all checkable deposits regardless of a notice of withdrawal requirement. The Board believes that, since the legislative history repeatedly refers to demand deposits as "checking accounts" it is likely that Congress meant to incorporate the longstanding agency interpretation into the statute.²⁰

drawn); 13 Fed. Res. Bull. 609 (1927) (special reserve savings accounts that "in actual practice" are subject to check).

¹⁹ In *United States League of Savings Associations v. Board of Governors*, 595 F.2d 888 (D.C. Cir.) (table), *cert. denied*, 444 U.S. 920 (1979), the District of Columbia Circuit obviously believed that a deposit arrangement that functions as a checking account should be treated as such regardless of the retention of a notice of withdrawal requirement. The Tenth Circuit has adopted the same view in invalidating a similar deposit arrangement offered by certain savings and loan associations. *Otero Savings & Loan Association v. Federal Home Loan Bank Board*, 665 F.2d 279 (10th Cir. 1981).

²⁰ See *Lorillard v. Pons*, 434 U.S. 575, 580-81 (1978) (When Congress incorporates prior statutory language in new stat-

Function of NOW accounts as checking accounts. NOW accounts in practice perform the same function as conventional demand deposits, are advertised and used in a manner indistinguishable from conventional bank checking accounts, and are subject to the same reserve requirements as conventional demand deposits. It is uniformly recognized that NOW accounts operate as demand checking accounts and that checks drawn on these accounts are paid by the drawee institutions on demand, just like conventional checking accounts. *E.g., New York State Bankers Association v. Albright*, 38 N.Y. 2d 430, 381 N.Y.S. 2d 18, 343 N.E. 2d 735 (1975) ("Manifestly and unabashedly", the NOW account is intended to be the equivalent of a checking account); Kaplan, *Federal Legislative and Regulatory Treatment of NOW Accounts*, 91 Banking L.J. 439, 440 (1974) ("NOW accounts permit money transfers to third parties in much the same manner as conventional checking accounts").

Like a conventional checking account, the holder of a NOW account makes withdrawals by means of a demand draft that may be issued to a third party as a means of transferring funds to the third party from the depositor. The payee of the NOW draft deposits it in the payee's bank for collection from the drawee institution. The drawee institution then charges the depositor's NOW account to pay the draft. *See New York State Bankers Association v. Albright*, *supra*. NOW drafts are cleared through the Federal Reserve check collection facilities as demand items, exactly like conventional checks.

Because of the third party payment feature, NOW accounts are used by depositors to pay bills and to

ute, Congress is presumed to have incorporated longstanding administrative interpretations of earlier statutory language.)

perform other financial transactions, the very function of a conventional demand deposit. A survey conducted by the American Bankers Association of the operation of NOW accounts in New England, where such accounts were first permitted on an experimental basis, concluded that:

... a large number of depositors are using the NOW accounts as their *main transaction account*. Indeed, some New England banks report that usage of NOW accounts closely resembles the usage of demand deposit accounts.²¹

The Board notes that NOW accounts are uniformly advertised as checking accounts with little, if any, reference to the fact that they may be subject to a 14-day notice of withdrawal requirement. Not only is the right to require advance notice of withdrawal ordinarily not invoked with respect to such accounts, but it is apparent from the nature of a NOW account that, once a draft has been drawn on such an account, the funds in the account that cover the draft cannot effectively be made subject to a notice of withdrawal requirement. Because withdrawals from NOW ac-

²¹ Hoffman and Herman, *NOW Accounts in New England* in American Bankers Association, *Studies on the Payment of Interest on Checking Accounts* 31 (1976) (emphasis added). *See also* Cates and Chase, *The Payment of Interest on Checking Accounts: A Report to the South Carolina Bankers Association* 29-30 (1976) (NOW experience in Massachusetts and New Hampshire indicates most holders of commercial bank NOW accounts use them as substitutes for regular demand deposit accounts); Simpson and Williams, *Recent Revisions in the Money Stock*, 67 Fed. Res. Bull. 539, 542 (1981) (70 to 80 percent of funds deposited in new-type checking accounts, *e.g.*, NOW accounts, opened in early 1981 were shifted from conventional demand deposits).

counts are made by demand drafts issued directly to third party payees, the drawee institution would face a serious loss of good will if it attempted to invoke that right against drafts drawn against the NOW account.²² The Board is aware of no instance in which the notice requirement has been invoked on a NOW account.²³

The history of the federal NOW account authorization legislation evidences the Congressional understanding of such accounts as demand deposits. The 1974 prohibition of NOW accounts (except in certain New England states) was a direct response to and recognition of the fact that the ability to make withdrawals by check converted the traditional in-

²² By refusing temporarily to pay NOW drafts on demand, the institution would refuse payment, not to the holder of the NOW account, but to a third party payee, such as a merchant, who has no necessary relationship with the institution and who has given value for the NOW draft. Payees would thereafter refuse to accept NOW drafts drawn on that institution. NOW account depositors would thus be forced to withdraw the NOW account funds and place them in a more acceptable payment vehicle. Also, under federal law, an institution that wishes to invoke the notice of withdrawal requirement is obligated to impose such a requirement on every other account of a similar nature. 12 C.F.R. § 217.5(a).

²³ The notice requirement on occasion has been invoked with respect to ordinary savings accounts, which do not contain funds used to pay bills and are not checkable. See *American Banker*, June 22, 1976, p. 1, col. 2. Because the Board's interpretation concerns only accounts subject to the notice of withdrawal requirement that are *withdrawable by check*, it does not cover savings deposits, which are subject to the notice of withdrawal requirement but may not be withdrawn by negotiable order and thus that do not have transactional capability. See 12 C.F.R. § 217.5(c) (1).

terest-bearing savings account into a demand deposit and represented a device to circumvent Congress' 1933 ban on the payment of interest on demand deposits.²⁴ In effect, the legislation codified the Board's longstanding view that a checking account is functionally a demand deposit.²⁵ Indeed, if NOW accounts are not demand deposits, there would have been no need at all for legislation authorizing NOW accounts, since the prohibition on payment of interest applies only to deposits *payable on demand* and not to ordinary savings accounts.²⁶

Finally, the Monetary Control Act of 1980 requires depository institutions to maintain the same level of reserves against NOW accounts as are required to be maintained with respect to conventional demand de-

²⁴ 119 Cong. Rec. 16,071 (1973) (Remarks of Senator Brock stating, "Failure to ban "NOW" accounts infringes on a 40-year old statutory prohibition on the payment of interest on checking accounts."); *Id.* at 15,005 (Remarks of Cong. Johnson stating, unless NOW accounts are limited, "the net result will be nationwide, all banks will pay interest on *checking accounts*"); *Id.* at 15,002 (remarks of Rep. Patman, characterizing NOW accounts as permitting interest on *demand deposits*); *Id.* at 16,486 (remarks of Sen. Proxmire to the effect that NOW accounts permit "one to earn interest on his *demand deposits*").

²⁵ S. Rep. No. 368, 96th Cong., 1st Sess. 5 (1979). "[NOW accounts] are the functional equivalent of interest bearing checking accounts." *Accord* 125 Cong. Rec. H7613 (daily ed. Sept. 10, 1979) (Remarks of Cong. St Germain).

²⁶ The fact that NOW accounts are limited to consumers has no significance under the BHC Act, in which the definition of "bank" depends on the *demand checking* feature of *deposits*, not on the commercial or consumer nature of the depositor (unlike the loan part of the "bank" definition).

posits.²⁷ This requirement reflects the Congressional belief that these accounts are functionally equivalent and form the basis of our country's medium of exchange. H.R. Rep. No. 263, 96th Cong., 1st Sess. 4 (1979). Thus, the Monetary Control Act also in effect codified the Board's early administrative rule that imposed on *checkable* accounts (whether or not subject to a notice of withdrawal requirement) the same reserve requirements applicable to conventional demand deposits.

Several commenters stated that the proposed definition of demand deposit is overly broad and could cover some types of institutions that should not be covered. The Board is aware that, under its interpretation, industrial banks and similar institutions that may currently offer NOW accounts and make commercial loans will be covered as "banks" under the Act. As noted, the legislative history of the Act manifests a Congressional intent not to cover such institutions as they operated in 1966. The intent was premised upon the belief and the testimony of the industrial banking industry before Congress that such institutions did not offer checking accounts or engage in the commercial loan business. In recent years, industrial banks and similar organizations have been authorized to offer NOW checking accounts and to make commercial loans. Clearly, in light of this significant departure from the traditional and commonly accepted functions of industrial banking organizations, these institutions, which function essentially as banks, are not the type of institution Congress intended to exclude from the Act in 1966.

²⁷ 12 U.S.C. § 461(b)(1)(C). In contrast, Congress mandated no reserve requirement for traditional savings deposits. See 12 C.F.R. § 204.9(a).

Indeed, in the Garn-St Germain Act of 1982, Congress recognized the essential bank-like functioning of industrial banks and specifically made them eligible for FDIC insurance.²⁸

The Board believes that institutions that both offer NOW accounts, or other accounts that clearly are the functional equivalent of a demand deposit, and make commercial loans must be treated as banks in the interests of competitive equity and to prevent evasion of the Act and to ensure that its fundamental purposes are effected.

Some commenters stated that the proposed definition of demand deposit could call into question the status of certain types of accounts, such as money market deposit accounts, preauthorized transfer accounts, telephone transfer accounts, accounts accessible through ATM machines, various types of bill-payer accounts, and credit balance accounts accessible by negotiable check or draft. Under certain circumstances, it is possible that some of these accounts may fall into the category of deposits that the Board regards as demand deposits, especially if they function as checking accounts or the equivalent thereof. However, the Board does not believe it is necessary to treat such accounts as demand deposits for purposes of the regulation as currently written, since it is unlikely that there would be a significant number of depository institutions offering these accounts that do not also offer NOW or other checking accounts.

In this regard, the inclusion of the definition of demand deposits in Regulation Y should not be interpreted as affecting the present status of credit balances offered by investment companies chartered un-

²⁸ Pub. L. No. 97-320, § 703, 96 Stat. 1469, 1538-39, S. Rep. No. 536, 97th Cong., 2d Sess. 43 (1982).

der Article III of New York's banking law, which the Board has previously determined are not demand deposits for purposes of the Act. *European-American Bancorp*, 63 Federal Reserve Bulletin 595 (1977). The Board may determine to review the status of such credit balances at some future date upon request or upon the Board's own initiative, but does not intend by this action to address these types of accounts. Similarly, the Board's interpretation of demand deposits does not affect the status of deposits accepted in a *bona fide* fiduciary capacity, which the Board has determined are not demand deposits for purposes of the Act.

In the comments, concern also was expressed that the definition of demand deposit would result in the forced divestiture of some industrial loan company subsidiaries of bank holding companies that do not meet the eligibility requirements for FDIC insurance. Section 3(e) of the BHC Act requires that every bank that is a subsidiary of a bank holding company be insured by the FDIC. 12 U.S.C. 1842(e). This provision was added to the BHC Act at the Board's suggestion based on the Board's belief that the value of federal deposit insurance to the public is such that all banks should offer this service to their customers. See *Mercantile Bankshares Corporation*, 56 Federal Reserve Bulletin 596 (1970). The Board notes that, under the Act, an institution that qualifies as a bank under the Board's interpretation and that is owned by a company would be allowed two years to obtain FDIC insurance. This will provide time for Congress to consider amending section 3(e) of the Act to allow other types of qualified insurance as an alternative to FDIC insurance.

Concern also was expressed in the comments that, if NOW accounts are deemed to be demand deposits,

banks would no longer be permitted to pay interest on such accounts. The Board stresses, however, that a determination that NOW accounts are demand deposits for purposes of the BHC Act does not affect their status under other federal statutes. In particular, the Board's interpretation does not prevent institutions from continuing to pay interest on NOW accounts.

For the above reasons, the Board concludes that demand deposits in the bank definition include NOW accounts and similar deposits that the depositor may withdraw by check, draft, negotiable order of withdrawal, or similar instrument. Accordingly, the Board is adopting in Regulation Y the definition of the term demand deposit as proposed, with certain technical modifications.

Definition of Commercial Loan

In order to qualify as a bank under the BHC Act, an institution must, in addition to accepting demand deposits, be engaged in the business of making commercial loans. The final regulation reflects the Board's definition of commercial loan as a loan the proceeds of which are used other than for personal, family, household or charitable purposes. Moreover, as noted above, even consumer loans, when made to further a commercial purpose, such as to promote an affiliate's business, would be considered a commercial loan under the Act.

The final regulation includes as a commercial loan the purchase of such instruments as commercial paper, bankers acceptances and certificates of deposit, the extension of broker call loans, the sale of federal funds, and similar transactions. Some commenters have objected to the proposed inclusion of commercial

paper, certificates of deposit, bankers acceptances and federal funds as commercial loans as beyond the scope of the Board's authority under the Act and contrary to the terms of the Act and established Board interpretations thereof. The commenters state that these transactions are not loans, but rather passive investments, which typically are short term and effected through a secondary market as a means of investing idle funds or maintaining liquidity, and that these transactions do not present the evils of credit abuse and concentration of economic power at which the Act is aimed. These commenters also state that the definition would bring under the Act many institutions that were not intended to be covered.

The Board has considered these comments and, for the reasons set out below, has determined to adopt the definitions as proposed with certain modifications.

In the Board's judgment, these instruments as a matter of law establish a debtor-creditor relationship and constitute an extension of credit or loan. Since these loans result in the provision of funds to commercial enterprises, including banks, which are also commercial enterprises, and since they are not made for personal, family, household or charitable purposes, these loans are commercial loans for purposes of the bank definition in the Act.³⁰ Moreover, as set forth above, the Board believes this interpretation to be consistent with and necessary to ensure implementation of the Act, prevent evasions of its fundamental purposes, and carry out expressed legislative policies.

³⁰ Federal, state and local governments and their agencies are not regarded as commercial enterprises by the Board, and their debt obligations therefore would not be regarded as commercial loans.

Some commenters argue that the term commercial loan must be applied to encompass only those transactions traditionally denominated "commercial loans" by the parties to the transactions. There is nothing in the legislative history that supports such a proposition. On the contrary, the thrust of the 1970 Amendments was to cover all banking institutions regardless of size because such action was necessary to prevent the potential for the abuses about which Congress was concerned—conflicts of interest, risk, partiality in the granting of credit, and concentration of resources. In fact, the instruments covered by the Board's definition are loans to commercial enterprises, and institutions which engage in banking functions by accepting demand deposits and making such commercial loans are subject to the potential abuses which Congress sought to prevent through a broadly applicable Bank Holding Company Act.

Moreover, the interpretation proposed by the commenters would deny to the Board any authority to prevent evasion of the Act by covering instruments that are in fact loans to commercial enterprises but take non-traditional forms. This approach would permit banks to structure their lending transactions to avoid the coverage of the Act and to circumvent its purposes. The courts, however, have recognized the authority of the Board to look beyond form to the substance of a transaction in order to prevent an evasion of the purposes of the Act.³⁰

As a first and preliminary matter, all of the instruments covered by the Board's definition are in

³⁰ See *Wilshire Oil Co.*, *supra* at 739-40. Indeed, the court agreed that section 5(b) of the Act enables the Board to prohibit activities that are technically outside the literal terms of the Act in order to prevent a clear evasion of the purposes of the Act. *Id.* at 740.

a technical legal sense "loans" since a debtor-creditor relationship is created in each. The term "loan" is generally defined as any transaction as a result of which a party advances money and obtains an absolute promise to repay, and generally involves the following elements: a principal sum placed with a borrower, an agreement that interest is to be paid on that sum, and a recognition by the receiver of the money of a liability for the return of the principal amount with interest. *See e.g.* Black's Law Dictionary 1085 (4th rev. ed. 1968). As explained in detail below, each of the instruments creates a debtor-creditor relationship meeting these standards and thus falls within the term "loan" in section 2(c) of the Act.

Second, the definition in section 2(c) requires that the loan be "commercial." The Supreme Court has stated that "[c]ommercial loans, generally speaking, are relatively short-term loans to business enterprises of all sizes, usually for purposes of inventory or working capital." *United States v. Connecticut National Bank*, 418 U.S. 656, 665 (1974). As indicated, the instruments listed in the regulation provide funds to commercial organizations, as in the case of commercial paper and bankers acceptances, or, as in the case of certificates of deposit or federal funds, to banks, which also are commercial enterprises.³¹ Moreover, the maturity, interest rate, and credit risk of all of these instruments is generally comparable to that of a short-term, prime quality commercial loan.³² Each

³¹ *See United States v. Philadelphia National Bank*, 374 U.S. 321, 343 (1963).

³² Although some commercial loans are of medium term, the traditional commercial loan is a short term instrument. *United States v. Connecticut National Bank*, 418 U.S. 656,

of these instruments typically provides short-term funding for working capital or current operations such as the financing of inventory. In addition, for each of these instruments, the lender generally will not extend funds unless it or a third party has accomplished a credit analysis to demonstrate that the borrower is capable of repaying the extension of credit from current income. In short, the instruments described in the Board's definition are loans for a commercial purpose—in other words, commercial loans.

The following discussion demonstrates that, both in terms of function and in terms of the legal obligation created, the instruments covered by the regulation are commercial loans for purposes of the BHC Act.

Commercial Paper. Commercial paper is a prime quality, short-term unsecured promissory note establishing a debtor-creditor relationship between lender and borrower. It is generally used as a financing device by large, financially strong corporate borrowers to obtain funds for seasonal or working capital purposes such as the financing of inventory. The maturity of commercial paper is generally 60 days or less, although it can have a maturity of up to 270 days. Commercial paper is generally sold in denominations of \$100,000 or more. Although it is negotiable, it is generally held to maturity and interest rates are fixed.³³

665 (1974); Munn and Garcia, *Encyclopedia of Banking and Finance* 572 (8th rev. ed. 1983); Stigum, *The Money Market* 76 (1983).

³³ Stigum, *supra*, at 625-41; Hurley, *The Commercial Paper Market*, 63 Federal Reserve Bulletin 525 (1977); Munn and Garcia, *supra* at 196. Interest is usually paid on commercial paper on a discount basis.

It is uniformly agreed that the purchase of commercial paper by a bank is a commercial lending transaction. Indeed, the Comptroller of the Currency has taken the position that the purchase of commercial paper is "after all nothing but [a] loan to industrial corporations" and thus qualifies as a loan under the lending limitations in the National Bank Act and under the Glass-Steagall Act. Letters of February 24, 1972, and November 19, 1971. The term and denomination of commercial paper, its status as a promissory note; the uses to which the funds are put, and the type of credit analysis involved, all mean that commercial paper is a commercial loan for purposes of the BHC Act.³⁴

Certificates of Deposit. A certificate of deposit ("CD") is an instrument evidencing a deposit with a bank for a specified period of time, generally at a fixed rate of interest. The legal relationship established between the purchaser of a certificate of deposit and the bank that issues it is that of creditor and debtor, and the loan that the purchaser of the instrument effectively makes to the bank is an unsecured loan.³⁵ As is the case with commercial paper,

³⁴ Moreover, in terms of function, commercial paper is an important substitute for commercial loans from banks, and the amount of such paper outstanding often increases or decreases as a result of changes in the cost and availability of bank loans. Hurley, *supra*, at 525. Indeed, the origins of commercial paper in the early 19th century can be traced directly to the inability of the U.S. banking system to provide sufficient credit for larger corporations that experienced significant seasonal swings in their need for credit. Stigum, *supra*, at 626.

³⁵ Bankers Desk Reference 84 (1978). See *Sutter v. Groen*, 687 F.2d 197, 200 (7th Cir. 1982) (certificate of deposit issued by bank and insured by FDIC is "a type of promissory note");

large denomination CDs that are traded in the money market are usually short-term, negotiable instruments, and typically have a maturity of from one to six months. The minimum denomination of such CDs is usually \$1 million.³⁶

The use of large denomination CDs with negotiable rates and maturities was originated by large banks in the 1960s as a method of providing additional funding for their operations, and has now become a key funding source for banks.³⁷ Banks use large denomination CDs to provide short term funding for their commercial operations in the same manner that other business organizations use commercial paper to raise working capital.³⁸ Moreover, as is the case with purchasers of commercial paper, purchasers of large

Wightman v. American National Bank, 610 P. 2d 1001, 1004 (Wyo. 1980) ("a certificate of deposit is simply a commercially glamorous name for a promissory note"); 2 *Anderson on the Uniform Commercial Code* 615 (1971) ("The differences between a certificate of deposit and a promissory note are merely formal. In substance and legal effect the two instruments are the same. . .").

³⁶ Stigum, *supra* at 525-26; Munn and Garcia, *supra*, at 608.

³⁷ Stigum, *supra* at 107. By 1960, the demand for loans at large New York City banks significantly exceeded the ability of those banks to fund loans from traditional sources such as savings deposits. At the same time, many large corporations had money they would be prepared to lend to large banks if the instrument evidencing the loan provided a relatively high rate of return and was negotiable. The large denomination CD satisfied this need. Stigum, *supra* at 35-36, 107-08.

³⁸ Controlling the amount of CDs that it issues is one of the principal devices by which a bank can make short term adjustments to the volume of loans it has outstanding. Thus, when loan demand is up, banks issue more CDs in order to make more loans. Stigum, *supra* at 36, 107.

denomination CDs engage in credit analysis of the issuers of these instruments, and establish limits for the amount that they are prepared to purchase from any particular issuer.³⁹ In sum, for purposes of the Bank Holding Company Act, a large denomination certificate of deposit is a commercial loan.

Some banks purchase CDs in denominations as small as \$100,000. Since such CDs are fully insured by the FDIC, they involve no credit risk. In all other respects, however, such CDs function as commercial loans to other banks, presenting the same potential for conflicts of interest and concentration of resources as other commercial loans. When a bank regularly purchases CDs of other banks, or otherwise makes interest bearing deposits on a regular basis, the Board believes the purchasing bank is engaged in the business of making commercial loans.⁴⁰ The Board's commercial loan definition therefore encompasses the regular purchase of smaller CDs or other interest bearing deposits.⁴¹

³⁹ Stigum, *supra* at 530. As a result of this fact, even the largest banks can experience difficulty in issuing CDs if their performance raises market concerns.

⁴⁰ The Board regards this construction of the term "engaged in the business" as being necessary to prevent evasion of the statute. It is also consistent with judicial construction of similar language in other statutes. *SEC v. Fifth Avenue Coach Lines*, 289 F. Supp. 3, 30-31 (S.D.N.Y. 1968). Cf. *Buckley v. New York Times*, 215 F. Supp. 893, 894 (E.D. La. 1963). Although the Board used a somewhat higher threshold with regard to Boston Safe, and certain savings and loan associations, the status of Boston Safe as a trust company and the independent regulatory scheme for savings and loan associations distinguishes those prior decisions.

⁴¹ On the basis of existing evidence, however, the Board does not believe that a non-interest bearing demand deposit is likely to function as a commercial loan, and such deposits are not covered by the definition of commercial loan.

Federal funds transactions. Federal funds transactions represent interest bearing loans by one depository institution of its deposits with a Federal Reserve Bank to another depository institution, generally on an overnight basis.⁴² The so-called "sale" of federal funds is not only legally the making of an unsecured loan to the purchasing bank, but it is so regarded by bankers.⁴³ Consequently, banks assess the credit risk associated with these transactions, and they will normally lend federal funds only to banks to which they have granted a line of credit.⁴⁴ Indeed, the Board has stated that the sale of federal funds is an unsecured loan from one depository institution to another.⁴⁵ Moreover, the purchase of Federal funds in substantial amounts on a regular basis is viewed by large financial institutions (which are themselves commercial enterprises) as a method of satisfying their basic funding needs.⁴⁶ In view of these facts, the Board concludes that federal funds should be regarded as commercial loans for purposes of the Act.

Bankers' Acceptances. A bankers' acceptance is an interest bearing loan—a debtor-creditor relationship—in the form of a draft with a payment date several months in the future that is drawn by a busi-

⁴² *Bankers Desk Reference*, 301-02, 367 (1978); Stigum, *supra* at 33-34, 105.

⁴³ Stigum, *supra* at 105.

⁴⁴ *Id.*

⁴⁵ Letter of June 8, 1972, to Laurence H. Stone regarding Boston Safe Deposit and Trust Company. In the context of Boston Safe's trust company activities, the Board concluded that sales of federal funds by Boston Safe were loans but were not commercial loans.

⁴⁶ Stigum, *supra* at 374-76.

ness on a specified bank, and that has been accepted for payment by that bank.⁴⁷ The use of bankers acceptances provides an alternative to a direct extension of commercial credit for the business which initially secures the letter of credit under which the draft is drawn.⁴⁸ By accepting the draft, the issuing bank has made the draft a primary obligation of the bank. After creating the acceptance, the bank may discount it and retain the instrument until maturity as part of its commercial loan portfolio. Alternatively, in order to raise funds to be used in the bank's current business, it may sell the acceptance in the money market. The buyer of the acceptance receives an unconditional promise from the selling/accepting bank that it will pay the draft at maturity. In turn, the accepting bank looks to the business that is the account party on the draft for repayment; the purchaser of the acceptance may also recover from the account party if the accepting bank defaults.

The direct effect of purchasing a bankers' acceptance is to provide funds to the accepting bank, which is itself a commercial enterprise.⁴⁹ Moreover, in view of the liability of the business that is the account party on the draft, the purchase of a bankers' acceptance from the accepting bank or any other party is the functional equivalent of purchasing a commercial loan that is guaranteed by the accepting bank. On the basis of the preceding discussion, the Board

⁴⁷ *Bankers Desk Reference* 304 (1978); Munn and Garcia, *supra* at 69-71. Interest is paid on a discount basis.

⁴⁸ Stigum, *supra* at 39.

⁴⁹ The purchase of a bankers acceptance from a dealer in such instruments similarly provides funds to the dealer, which is a commercial enterprise.

concludes that the purchase of a bankers' acceptance should also be regarded as a commercial loan.

Some commenters have objected to the inclusion of these money market instruments as commercial loans on the basis that they are often purchased through brokers with no direct negotiation with the issuer, and should therefore be classified as passive investments rather than commercial loans.⁵⁰ However, a substantial portion of the transactions in all of these instruments occurs through direct negotiations between lenders and borrowers and, even when purchased through brokers, the lender knows the borrower's identity. Based on its experience, the Board is aware that holders of large amounts of so-called money market instruments relative to the size of the borrower are in a position to influence the conduct of the borrower, and do at times exercise this influence.⁵¹

⁵⁰ The absence of direct negotiation with the borrower is a characteristic of the purchase of a participation interest in a direct extension of commercial credit, a technique commonly used by commercial banks to spread the risk of default and increase the total amount of funds that may be loaned to one customer. It is only the "lead" bank in a participated lending transaction that typically negotiates directly with the borrower. However, most courts that have considered the issue have concluded that a bank that purchases a participation in a commercial loan is purchasing a commercial loan rather than a security. *E.g.*, *Union Planters National Bank v. Commercial Credit Business Loans, Inc.*, 651 F.2d 1174 (6th Cir.), *cert. denied*, 45 U.S. 1124 (1981).

⁵¹ For the most part, the influence that any lender has over a borrower in an arms-length transaction is likely to be an influence that encourages moderation and prudence. It is the potential for abuse of this relationship, however, that prompted Congress to enact the Bank Holding Company Act. Indeed, in deciding to extend the Acts' coverage to one-bank holding companies, Congress stated that there had been "no

Moreover, a "nonbank bank" could, for example, favor its affiliates by purchasing the CDs or commercial paper of those affiliates, or by purchasing such instruments from customers of its affiliates. Similarly, it could refuse to purchase such instruments from competitors of its affiliates and, as noted above, "understandings" could well develop that would lead to commercial lending by indirect means, *e.g.*, through affiliated commercial finance companies or other reciprocal lending arrangements.

Thus, the Board finds that the financial instruments discussed above are, in fact, properly categorized as loans providing for the extension of credit from one commercial enterprise to another. Moreover, the Board believes it is proper to include these instruments within the scope of the term commercial loan as used in the Act in order to carry out the Act's basic purposes: to maintain the impartiality of banks in providing credit to business, to prevent conflicts of interest, and to avoid concentration of control of credit. As noted above, the proliferation of nonbank banks owned by companies of very substantial size outside the prudential rules of the Bank Holding Company Act suggests that the dangers of evasion of the Act are real and that action to remedy potential abuses is both necessary and desirable.

Several commenters asserted that commercial paper, certificates of deposit and other money market instruments are merely passive investments having the characteristics of a security rather than a loan. Although an occasional purchase of commercial paper,

major abuses effectuated through the one-bank holding company device . . . the legislation is to prevent possible future problems rather than to solve existing ones." S. Rep. No. 1084, *supra*, at 4.

a certificate of deposit or other money market instrument would not mean that the purchaser is engaged in the business of making commercial loans, this has little relevance for a bank that regularly purchases such instruments as one of its basic business operations.⁵² Moreover, a commercial loan may be characterized as an investment and vice versa.⁵³

Although for purposes of the Bank Holding Company Act, the distinction between a commercial loan and an investment appears largely irrelevant, the distinction has been made for the purposes of certain federal securities laws.⁵⁴ The cases interpreting these statutes have set forth certain criteria for distinguishing a transaction that is essentially a commercial loan from a transaction that is essentially an investment embodied in a security regulated by the federal securities laws. Under the criteria employed

⁵² The Board regards an institution that engages in such transactions on anything more than an occasional basis as being engaged in the business of making commercial loans. See n. 40, *supra*.

⁵³ In *C.N.S. Enterprises, Inc. v. G&G Enterprises, Inc.*, 508 F.2d 1354, 1359, *cert. denied*, 423 U.S. 825 (1975), the U.S. Court of Appeals for the Seventh Circuit made precisely this point when it stated: "In one sense every lender of money is an investor since he places his money at risk in anticipation of a profit in the form of interest. Also in a broad sense every investor lends his money to a borrower who uses it for a price and is expected to return it one day."

⁵⁴ See, *e.g.*, *American Bank & Trust Company v. Wallace*, 702 F.2d 93 (6th Cir. 1983); *Bellah v. First National Bank of Hereford, Texas*, 495 F.2d 1109 (5th Cir. 1974); *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252 (9th Cir. 1976). *Cf. Marine Bank v. Weaver*, 455 U.S. 551 (1981); *Exchange Nat. Bank v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976).

in these cases, the purchase by a financial institution of commercial paper, certificates of deposit, bankers acceptances or the sale of federal funds possesses the qualities primarily associated with a loan rather than these qualities associated with a security.⁵⁵

Some commenters asserted that the purchase of retail installment loans by a bank should not be regarded as involving commercial lending, because the ultimate recipient of the funds are consumers. However, the effect of purchasing an installment loan is to finance the day-to-day operations of the retailer involved, and to provide funds with which the retailer may purchase additional inventory or finance retail sales. Thus, the effect of the purchase is to promote the retailer's commercial business. Moreover, if the retailer is an affiliate of the lending bank, the purchase of its retail installment paper by the bank is precisely the type of transaction criticized in the legislative history of the Act, as discussed above—the retail affiliate has an assured line of credit to finance its sales, thereby giving it an advantage over its competitors. Even though a purchase of such loans may not involve an affiliate, and may be without recourse, the bank is supplying funds to a commercial enterprise, and the retailer generally maintains an ongoing business relationship with the bank, which provides the bank with an opportunity to influence the retailer's affairs through its willingness to continue to provide or deny additional credit. Thus, consistent with a 1976 Board staff opinion, the Board regards the purchase of retail installment loans as a commercial lending transaction, and is so modifying its commercial loan definition in the regulation.

⁵⁵ *Id.*

One other type of loan specified as a commercial loan in the regulation adopted by the Board is a broker call loan. A broker call loan is a loan to a securities broker or dealer that is payable on demand and is made for the purchase or carrying of securities. Munn and Garcia, *supra*, at 137, 154. The Board's staff issued an opinion in 1976 that such loans are not commercial loans on the basis that such loans are a passive medium of investment that do not involve a close lender-borrower relationship. Letter of January 26, 1976.

However, broker call loans are loans; they are clearly made for commercial purposes; and they thus fall within the Bank Holding Company Act's definition of commercial loan. While the staff's interpretation may have been appropriate in a different factual context, in view of the rapidly expanding use of the nonbank bank loophole to evade the BHC Act as described above, the Board believes it is appropriate to regard broker call loans as commercial loans.⁵⁶

Several commenters asserted that the Board's proposed commercial loan definition represented an abrupt and unwarranted reversal of prior positions taken by the Board. The fundamental rule which the Board established in 1971 is that the term "commercial loan" should encompass all loans other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family, or household purposes, or for charitable purposes. Letter of July 1, 1971, to Greater

⁵⁶ Trust company subsidiaries of bank holding companies are permitted to make broker call loans and purchase money market instruments. However, such subsidiaries are not permitted to accept general purpose demand deposits, and therefore are not "banks" under the bank definition.

Providence Deposit Corporation. In only three subsequent cases⁵⁷ over a ten-year period was the Board prepared to allow companies that could not qualify as bank holding companies to engage in demand deposit-taking while placing those deposits in money market commercial loans. The decisions in these cases represented a willingness by the Board to refrain from applying the full scope of the Act in conditions that did not appear to generate the potential for its evasion. Now that conditions have changed so that widespread evasion of the statute has developed through the combination of demand deposit-taking and the placing of the funds thus generated in money market commercial loans, regulatory action to apply the Act to all kinds of demand deposits and commercial loans is necessary.

The courts have held that an agency may alter its interpretations in response to changing circumstances if it provides a reasoned explanation for its action. In *American Trucking Association, Inc. v. Atchinson, Topeka & Santa Fe Railway Co.*, 387 U.S. 397, 416 (1967), the Supreme Court ruled that:

Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and of fair and prudent administration, to adopt their rules and practices to the nation's needs in a volatile, changing economy.

In its *Dreyfus* decision and in this notice, the Board has detailed the factors and considerations that underlie its interpretation and believes that its action, as explained herein, is both appropriate and neces-

⁵⁷ Letters of June 8, 1972, to Laurence H. Stone; March 11, 1981 to Mr. Robert C. Zimmer; and May 28, 1981, to Mr. R. S. Miller, Jr.

sary in light of the purposes of the Act and is within the Board's express authority under section 5(b) of the BHC Act. Moreover, the Act clearly contemplates changes in interpretation to address changes in market conditions in order that the fundamental purposes of the Act be maintained and to prevent a serious competitive imbalance between competing institutions fostered by the change in market conditions. The definition of demand deposit and commercial loan that the Board has adopted will accomplish these objectives.

The Board's action on the definition of the term "bank" as used in the Act is also intended for the purpose of maintaining the structure established by Congress for limiting the association of banking and commercial enterprises in order to avoid the preemption of Congressional discretion through actions that have the effect of evading the Act. Various proposals to confirm or change the present structure are now before the Congress and the ability of Congress to act on these proposals would be limited by rapid expansion of the use of nonbank banks. Changes in the basic framework established by Congress are properly a matter for Congressional decision and the Board looks to legislative action in the near future to clarify both the proper dividing line between commerce and banking and to establish the proper scope of bank holding company powers to deal with changed market conditions.

Accordingly, for the reasons set out above, the Board is adopting in Regulation Y, with certain technical modifications, the definition of the term "commercial loan" as proposed, and in addition is incorporating in that definition the purchase of retail installment loans.

APPENDIX C

[SEAL]

RICHARD F. CELESTE
Governor

STATE OF OHIO
DEPARTMENT OF COMMERCE
Two Nationwide Plaza
Columbus, Ohio 43215

Telephone:
Area Code 614—466-3636

January 9, 1985

Mr. William W. Wiles
Secretary of the Board
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Wiles:

The State of Ohio has received notification that pending before the Board are various applications which seek approval to create so-called "non-bank banks". These applications are recognized by the entire industry to be in opposition to the intent of the Bank Holding Company Act and the best interests of the various states and the dual banking system. Therefore, Ohio must oppose all such applications which are, or will be, before the Board for consideration, and, specifically, the applications which seek to locate such activities in Ohio.

I

Clearly, Ohio's statutory intention is to prohibit the types of institutions which would be created by the

approval of the pending applications. These are banks, chartered as such by the Comptroller and identified as such by the applicants, the industry and, if established, by the public. These banks are foreign subsidiaries of bank holding companies. Admittedly, these entities would be impermissible if the pending applications identified the very same subsidiaries as banks. Because the laws of Ohio do not specifically permit interstate banking, as necessitated by the Douglas Amendment, such subsidiaries are in violation of federal law. Similarly, two different sections of the Ohio Revised Code specifically prohibit foreign banks from conducting banking activities in Ohio, except for the lending of money and licensed trust activities. These two sections (attached herewith) clearly indicate that Ohio has not yet decided to permit interstate banking into the state.

In considering the timing of these applications, it is important for the Board to be aware that Ohio is currently considering if, and, if so, how, interstate banking will be permitted within this state. It is anticipated that the legislation authorizing interstate banking will be reintroduced in this new legislative session, and such legislation may contain geographical limitations. Similar legislation was introduced late in the last session but the discussions had not run their full course. It is necessary that Ohio be given an opportunity to fully consider the very serious issues relating to interstate banking. Any approval of the pending applications would usurp these decisions from Ohio. Recognizing that Ohio has been approached to issue a state charter to an entity which is defined as a bank for state, but not federal, purposes, the understanding gathered from such an application process may well assist the legislature when

attempting to draft a bill regulating interstate banking. Ohio may not have the same discretion which the Board has in approving an application. This is primarily because the industry has long recognized that the Bank Holding Company Act was intended to prohibit this type of activity and Ohio, in addition to other states, relied on the federal statutes to avoid duplicity of regulation.

II

Ohio suggests that the benefits from the proposed activities do not outweigh the probable adverse effects. Because these types of applications, will be pursued only by large corporations, there will be a tendency to concentrate depository resources, something Ohio ~~statutes~~ recognize as unacceptable. (See O.R.C. 1111.02) Furthermore, unfair competition will result because only institutions large enough to afford the application, capital requirements, and attendant expenses will apply for these non-bank banks. As a result, the deposits will be gathered ever increasingly by an ever decreasing number of institutions.

III

We are all hopeful that Congress will this year address the problems caused by "non-bank banks". Certainly, it was never intended that the 1970 amendment to Section 2(c) of the Bank Holding Company Act permit the establishment of interstate banking networks, thereby surreptitiously undermining the very Act of which it was a part. It would also be difficult to explain the concomitant usurpation of state's rights which are recognized by the Douglas Amendment. Ohio respectfully requests that the Board exercise its discretion and authority and pro-

hibit the expansion of the "non-bank bank" problem by denying the pending applications.

Respectfully submitted,

/s/ Linda K. Page
LINDA K. PAGE
Superintendent
Division of Banks

Enclosures

cc: Mr. Michael O'Rourke
Legal Division
Mail Stop 13

STATE OF TENNESSEE
 DEPARTMENT OF FINANCIAL INSTITUTIONS
 Second Floor, James K. Polk Building
 505 Deaderick Street
 Nashville, Tennessee 37219-5384
 (815) 741-2236

W. C. ADAMS
 Commissioner

January 3, 1985

Mr. Michael Bradfield
 General Counsel
 Federal Reserve System
 Board of Governors
 20th and Constitution, Northwest
 Washington, D.C. 20551

Re: Application by Bank of Boston Corporation,
 Boston, Massachusetts to establish a national
 bank subsidiary pursuant to Section 4(c)(8) of
 the Bank Holding Company Act of 1956, as
 amended.

Dear Mr. Bradfield:

We have been advised by the Federal Reserve Bank of Boston that an application has been tendered by the Bank of Boston Corporation to establish a non-bank bank in Nashville, Tennessee. The purpose of this correspondence is to express our opposition to this application and other proposed applications to establish non-bank banks in Tennessee. We understand fully the liberal interpretation being applied to federal law allowing such banks to be established, however, we think it is contrary to the intent of the law and not in the best interest of Tennessee citizens. The Governor of Tennessee, the Legislature,

and the banking industry have all gone to great lengths to provide for an orderly progression for the Tennessee banking community into an interstate environment in accordance with the authority given the states in the Douglas Amendment to the Bank Holding Company Act of 1956, as amended. The Legislature has conducted hearings throughout the State to receive views of Tennessee citizens on the subject of interstate banking. Governor Lamar Alexander has appointed a Cabinet level committee to study in great detail the subject of interstate banking and its effect on interstate commerce, and as a result of that committee's work he has made certain recommendations and suggestions for new laws which would allow interstate banking in Tennessee. The banking industry has retained experts to conduct a study on interstate banking, and although there are different views maintained by Tennessee bankers, the Tennessee Bankers Association has arrived at a consensus for a regional interstate banking law being passed. All these events indicate that Tennessee is doing everything possible to provide for an orderly progression into the interstate banking environment. We feel this process was what was contemplated by Congress when they drafted the Douglas Amendment.

The proliferation of non-bank banks in Tennessee will make this process meaningless. To allow national banks to be established in Tennessee as non-bank subsidiaries of out-of-state bank holding companies circumvents the restrictions on interstate banking contained in the Bank Holding Company Act. Although Congress intended for each state to determine whether or not interstate banking should be allowed in their state, federal law is being interpreted to allow the Comptroller of the Currency to make that decision.

What is effectively happening is that through an interpretation of federal law, powers which were intended to be retained by the states are being usurped by an agency of federal government.

In 1983, Tennessee's Legislature passed a law as a result of a banking crisis which allowed for the establishment of industrial banks in Tennessee which could offer federally insured accounts. Although there was no intention by the Legislature to provide a means for out-of-state bank holding companies to establish such industrial banks, that was the result. Citicorp immediately applied to establish an industrial bank in Tennessee as a non-bank subsidiary of their bank holding company. Although the application to establish this industrial bank was criticized by the Fed, it was approved because there was no sound reason not to. However, Tennessee's Legislature had no intention to allow interstate banking at that time. In 1984 the Legislature repealed the law allowing for the establishment of industrial banks so that interstate banking would come to Tennessee in an orderly manner, and not as an unintended result of a liberal interpretation of legislation passed for some other purpose.

Tennessee's citizens, including the Administration, the Legislature, and the banking industry as a whole have gone to great efforts to respond to the changing banking environment and economic needs of the State. They have done so through a well informed, thoughtful process. Such a process was contemplated by the United States Congress as evidenced in federal law in the Douglas Amendment. To allow for that authority to be usurped and the whole process thwarted by approving establishment of non-bank banks in Tennessee is an injustice and violation of

states' rights. We encourage the Federal Reserve Board not to approve this application or others to establish national bank non-banking subsidiaries in Tennessee.

We appreciate your full consideration of this matter.

Very truly yours,

/s/ W. C. Adams
W. C. ADAMS
Commissioner of Financial
Institutions

WCA/sm

cc: Robert N. Brady
Assistant Vice President
Federal Reserve Bank of Boston
Boston, Massachusetts 02196

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[SEAL]

STATE OF NEW JERSEY
DEPARTMENT OF BANKING
CN 040
Trenton, N.J. 08625

DOMINICK A. MAZZAGETTI
Acting Commissioner

May 15, 1984

Board of Governors
Federal Reserve System
21st and Constitution Ave., N.W.
Washington, D.C. 20551

Re: Interstate Consumer Bank Applications

Gentlemen:

By letters dated April 26, 1984, May 8, 1984 and May 11, 1984, we advised the Comptroller of the Currency of our objections to the following applications for national banks to be chartered within the State of New Jersey, but not subject to regulation as banks under the Bank Holding Company Act:

The Bank of New York, N.A., for a charter to be located in the vicinity of Mount Pleasant Avenue and Livingston Avenue, Livingston, Essex County, New Jersey;

Citibank (New Jersey, N.A.) for a charter to be located at 110 South Jefferson Road, Jefferson Plaza, Whippany, Morris County, New Jersey.

Marine Midland Bank (New Jersey, N.A.) for a charter to be located in Morristown, Morris County, New Jersey;

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Irving Trust (New Jersey, N.A.) for a charter to be located in the vicinity of East Main and High Streets, Morristown, Morris County, New Jersey, and

Chase Manhattan Bank for a charter to be located in Hasbrouck Heights, New Jersey.

We hereby formally protest the applications of these institutions filed with the Board of Governors of the Federal Reserve and ask for the opportunity to be heard.

Very truly yours,

/s/ Dominick A. Mazzagetti
DOMINICK A. MAZZAGETTI
Acting Commissioner